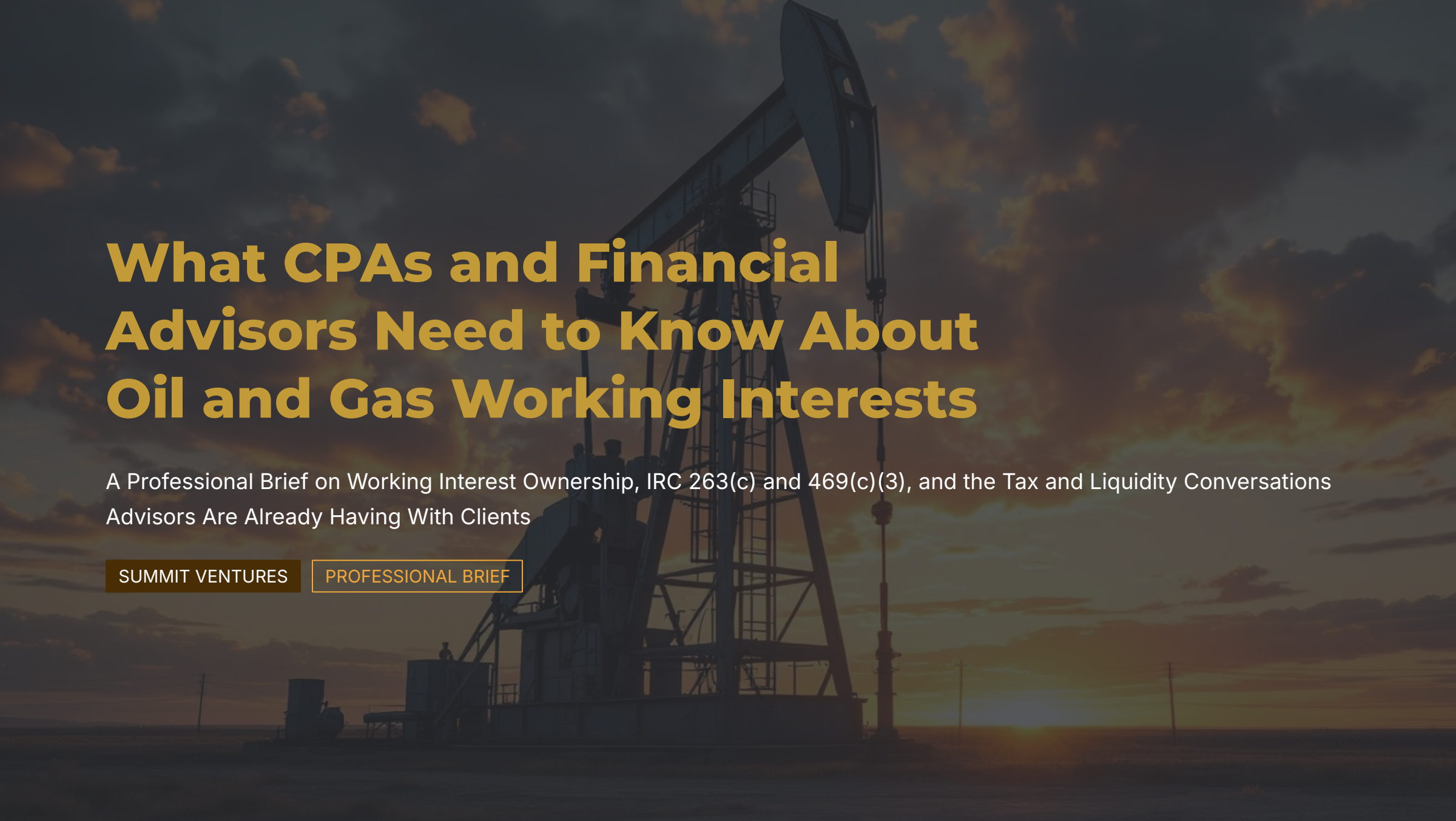

# What CPAs and Financial Advisors Need to Know About Oil and Gas Working Interests

A Professional Brief on Working Interest Ownership, IRC 263(c) and 469(c)(3), and the Tax and Liquidity Conversations Advisors Are Already Having With Clients

SUMMIT VENTURES

PROFESSIONAL BRIEF

# Executive Takeaway and Why It Matters

Most advisors already have the conversation. A client sells a business and faces a six or seven figure capital gains bill. A 1031 exchange clock is running out with no suitable replacement property identified. A high-income client has a one-time bonus or liquidity event that pushes them into the top bracket for a single tax year. These are not unusual situations for CPAs, enrolled agents, RIAs, qualified intermediaries, business brokers, estate planning attorneys, and commercial real estate brokers who work with high-net-worth individuals. What is less common is having a statute-grounded, well-documented asset class on hand to bring into that conversation with confidence.

Direct working interest ownership in oil and gas wells is one of the oldest tax-recognized asset categories in the Internal Revenue Code, with intangible drilling cost treatment under IRC Section 263(c) tracing back to Treasury guidance from 1916 and formal codification in 1954. It remains underused in most advisory practices, not because it lacks a statutory basis, but because the asset class has historically been associated with retail promotion, speculative drilling syndicates, and compliance gaps that made experienced advisors cautious. This brief is written peer to peer, for advisors who want the technical mechanics first and the positioning second.

### Business Sale

Client faces six or seven figure capital gains bill after exit

### 1031 Clock

Exchange deadline approaching with no suitable replacement property

### Spike Year

One-time bonus or liquidity event pushes client into top bracket

### The Gap

No statute-grounded asset class ready to bring into the conversation

# Context: Why Traditional Tools Fall Short

High-income clients routinely generate planning problems that traditional tools only partially solve. Qualified retirement plan contributions are capped well below what a seven-figure earner needs to meaningfully offset a spike year. Charitable strategies require giving away capital the client may want to retain. Real estate professional status and cost segregation help property owners but do little for a client whose income is W-2, 1099, or K-1 in nature with no real estate holdings. Meanwhile, a subset of clients, particularly those exiting a business, completing a 1031 exchange, or managing concentrated wealth, are actively asking their advisors about alternative asset categories that offer both diversification and a recognized tax treatment.

Direct working interest ownership sits in a distinct statutory lane from passive real estate or securities-based alternatives. The Internal Revenue Code treats a working interest, when properly held, differently than a limited partnership unit, a fund share, or a royalty interest. That distinction is the technical core of this brief, and it is the reason this category deserves a seat at the table in year-end planning and post-liquidity-event discussions.

### Retirement Plan Caps

Contribution limits fall far short of what a seven-figure earner needs to offset a spike year

### Charitable Strategies

Require giving away capital the client may want to retain

### Real Estate Status

Helps property owners but does little for W-2, 1099, or K-1 income with no real estate holdings

# The Key Issue: Two Distinct Statutory Provisions

The planning opportunity rests on two separate, commonly conflated statutory provisions, and advisors who can distinguish them bring more value to the conversation than those who treat "oil and gas investment" as a single undifferentiated category.

## IRC Section 263(c)

Implemented through Treasury Regulation 1.612-4, this provision allows an operator or working interest owner to elect to expense intangible drilling costs — the non-salvageable costs of drilling such as labor, fuel, drilling mud, chemicals, site preparation, and hauling — in the year incurred rather than capitalizing them.

Tangible drilling costs, including casing, wellhead equipment, and tanks, are capitalized and depreciated under IRC Section 168. Industry sources commonly describe intangible costs as representing a substantial majority of total well cost, though the specific split for any given well depends on its authorization for expenditure and individual facts.

## IRC Section 469(c)(3)

This is the provision that actually determines whether those deductions can offset a client's active income. The statute specifically excludes from passive activity treatment "any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to such interest."

This is a narrow and precise standard. It does not require a material participation or hours test, unlike the real estate professional exception many advisors already know well. What it does require is that the client hold the interest directly, or through a structure such as a general partnership that does not shield the client from operational liability.

⚠ A limited partnership interest, an LLC membership interest, or a fund share will not satisfy this exception, regardless of what the underlying assets are.

# Key Findings: The Statutory Framework

A composite summary of the statutory framework advisors should understand before any client conversation:

**1** **IRC 263(c) and Treas. Reg. 1.612-4**

Govern the election to expense intangible drilling costs rather than capitalize them, with tangible costs separately depreciated under IRC 168.

**2** **IRC 469(c)(3)(A)**

The provision that allows those deductions to offset active W-2, 1099, and K-1 income, but only when the interest is held directly or through a liability-exposed entity such as a general partnership.

**3** **IRC Section 465 At-Risk Rules**

Still cap any deduction at the client's real economic exposure in the activity. Nonrecourse financing does not increase the at-risk basis.

**4** **IRC Section 57(a)(2)**

Treats excess intangible drilling costs as a tax preference item for alternative minimum tax purposes for independent producers, with a long-standing relief framework tied to net oil and gas income that CPAs should model on a client-specific basis rather than assume applies uniformly.

**5** **IRC Sections 611 and 613A**

Provide a 15 percent percentage depletion allowance on gross income from production for independent producers and royalty owners — a benefit that continues once a well is producing and is not limited by the client's remaining cost basis.

**6** **IRC Section 461(h)**

Economic performance rules generally require drilling to begin within 90 days for a year-end intangible drilling cost prepayment to be deductible in that tax year — a timing detail that matters for December planning conversations.

**7** **Revenue Rulings 68-331 and 78-135**

Establish that a working interest in a producing oil and gas lease is treated as real property, like-kind to a fee interest in other real estate, for purposes that originally arose under Section 1031. The same rulings clarify that a partnership interest in the entity holding the working interest does not itself qualify, reinforcing that direct or liability-exposed holding is the operative requirement across multiple parts of the Code, not just Section 469.

# Analysis: Structure, Documentation, and the Summit Ventures Model

## Participation Model

Summit Ventures operates as an entrepreneurial joint venture platform rather than a pooled fund or securities offering. Clients who participate become working interest owners and active JV members in specific wells, with governance rights and operational transparency built into the structure rather than layered on afterward. Capital contribution, member onboarding, and ongoing reporting are designed around the statutory requirements described above — specifically the direct or liability-exposed holding structure that IRC 469(c)(3) and Revenue Ruling 68-331 both require. This is a structural decision, not a marketing one: a fund share or limited partnership unit cannot deliver the same tax treatment regardless of the underlying wells.

## Structural Elements

Three elements distinguish a properly structured working interest offering from a generic alternative asset pitch.

1

### Holding Documentation

Confirmation that the interest meets the direct-or-unlimited-liability standard, documented in writing

2

### Audit-Ready K-1 Reporting

Timely reporting that separates intangible drilling cost allocations, tangible cost depreciation, and depletion so a preparer is not reconstructing the split from scratch during filing season

3

### Well-Level Transparency

Access to the underlying authorization for expenditure and well-level detail an advisor or their client's tax preparer may want to review rather than taking cost allocations on faith

# Tax and Legal Considerations by Advisor Role

The relevance of working interest ownership varies by advisory role. Here is how the framework applies across the professional relationships most likely to encounter this planning opportunity:



## CPAs and Tax Professionals

A client planning option with a genuine statutory basis for offsetting active income in a high-income year, paired with K-1 scheduling built for a compressed filing season rather than a source of reconciliation headaches.



## RIAs

Diversification into a real, directly owned asset category with a distinct tax treatment from securities-based alternatives, evaluated alongside a client's existing portfolio rather than replacing it.



## Qualified Intermediaries

The Revenue Ruling 68-331 line of authority is directly relevant to clients evaluating replacement property options, though a QI should not make an independent legal determination and should route that question to the client's own tax counsel.



## Business Brokers and M&A Advisors

The relevant moment is the period immediately after a business sale closes, when a client is deciding how to deploy proceeds and manage a concentrated gain, and a documented, statute-grounded option is a useful addition to that conversation.

## Estate Planning Attorneys

Direct working interest ownership is a distinct asset class with its own reporting and succession characteristics worth understanding before it appears inside a client's broader estate structure.

## Commercial Real Estate Brokers

The parallel to a 1031 timeline is the most relevant entry point — understanding that any replacement property determination remains the client's tax and legal advisors' responsibility, not the broker's.

# 2026 Tax Context and Current-Year Planning

Current tax-year context is also worth noting for 2026 planning conversations.

### One Big Beautiful Bill Act

Signed in July 2025, this legislation made 100 percent bonus depreciation under IRC 168(k) permanent for qualifying property, reversing the phase-down schedule advisors had been tracking under prior law.

### 2026 Capital Gains Rates

Federal long-term capital gains brackets top out at 20 percent, with a top effective rate near 23.8 percent once the net investment income tax is included — relevant context for any advisor comparing the ordinary-income offset available under 469(c)(3) against a capital gains strategy for the same client.

### Permanent Bonus Depreciation

The permanent 100% bonus depreciation under IRC 168(k) creates new planning opportunities when combined with the IDC election under 263(c) for clients with qualifying capital deployment in the current year.

> Advisors comparing the ordinary-income offset available under 469(c)(3) against a capital gains strategy for the same client should model both paths against the client's full tax position, including AMT exposure, before recommending either.

# Recommendations, Implications, and Due Diligence Questions

## Recommendations

Advisors evaluating this category for a client conversation should start with the holding structure question before anything else: will the client hold the working interest directly or through an entity that does not limit liability, and can that be documented in writing.

From there, confirm that K-1 reporting will separate intangible cost, tangible cost, and depletion line items in a format the client's preparer can use without reconstruction.

Finally, treat the AMT preference calculation under IRC 57(a)(2) and the at-risk limitation under IRC 465 as client-specific modeling exercises, not boilerplate assumptions, since both depend on the individual client's broader tax position.

## Implications

For advisory practices, the implication is less about adding a new product line and more about having an additional, well-documented answer ready when a client's situation calls for it. A CPA who can explain the difference between Section 263(c) timing and Section 469(c)(3) active-income treatment — in the same conversation where they are also reviewing a client's estimated payments or AMT exposure — is offering a materially deeper service than one who simply forwards a brochure. The same is true for an RIA fielding a diversification question, a QI managing a replacement property conversation, or an estate attorney reviewing a client's asset mix ahead of a planning update.

## Due Diligence Questions

Advisors considering this category with a client should work through the following before any capital is committed:

1. Does the proposed holding structure satisfy the direct-or-unlimited-liability standard under IRC 469(c)(3)(A), and is that documented in the governing agreement rather than implied?
2. Will the K-1 separate intangible drilling cost, tangible cost depreciation, and depletion allocations in a format usable for the client's return?
3. What is the client's at-risk basis under IRC 465, and does it support the deduction being discussed?
4. Does the client's broader AMT position make the IRC 57(a)(2) preference calculation material this year?
5. For QI and 1031-adjacent conversations, has the client's own tax counsel reviewed whether Revenue Ruling 68-331 applies to the specific transaction, rather than relying on a general industry analogy?

# Next Steps: Work With Summit Ventures

Summit Ventures works with CPAs, RIAs, qualified intermediaries, business brokers, estate planning attorneys, and commercial real estate brokers as an institutional resource, not a referral pipeline. That includes back-office educational support for your practice, tax opinion letters available for review by a client's own counsel, and K-1 scheduling built around how tax professionals actually file returns rather than around a retail investor timeline.

If a technical discussion of the working interest exception, the IDC election, or Revenue Ruling 68-331 would be useful for a specific client situation your practice is navigating, that conversation can be scheduled directly with Summit's technical team, advisor to advisor.

> This brief is intended as a starting reference for that conversation, not a substitute for your own review of a specific client's facts, and any participation decision should be made only after the client's own CPA, attorney, or financial advisor has reviewed the governing documents and the client's individual tax position.

## Sources and References


Internal Revenue Code Section 263(c) and Treasury Regulation 1.612-4, governing the election to expense intangible drilling costs.

Internal Revenue Code Section 469(c)(3)(A), the working interest exception to passive activity loss treatment, requiring direct holding or holding through an entity that does not limit liability.

Internal Revenue Code Section 465, at-risk limitation rules. Internal Revenue Code Section 57(a)(2), excess intangible drilling costs as an alternative minimum tax preference item for independent producers.

Internal Revenue Code Sections 611 and 613A, percentage depletion allowance for independent producers and royalty owners. Internal Revenue Code Section 461(h), economic performance and the 90-day drilling exception relevant to year-end IDC prepayment timing.

Revenue Ruling 68-331 (1968-1 C.B. 352) and Revenue Ruling 78-135, addressing the treatment of oil and gas working interests as real property and the limits of that treatment when held through a partnership interest.

One Big Beautiful Bill Act (signed July 2025) and IRC Section 168(k), permanent 100 percent bonus depreciation for qualifying property. 2026 federal long-term capital gains rate brackets and the net investment income tax, as published by the IRS for the current filing year.


**Schedule a Technical Discussion with Summit Ventures**