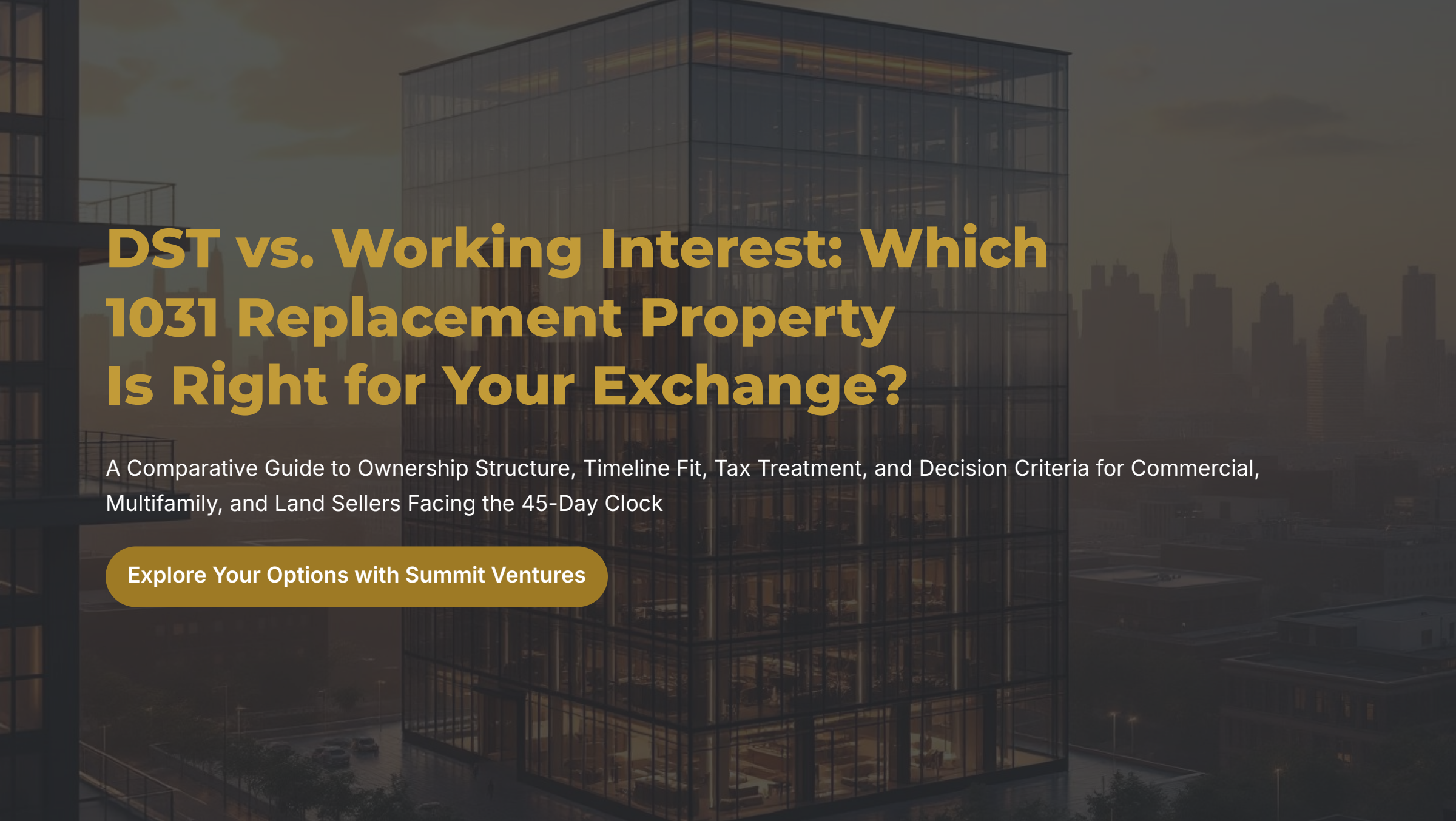


DST vs. Working Interest: Which 1031 Replacement Property Is Right for Your Exchange?

A Comparative Guide to Ownership Structure, Timeline Fit, Tax Treatment, and Decision Criteria for Commercial, Multifamily, and Land Sellers Facing the 45-Day Clock

Explore Your Options with Summit Ventures

The 45-Day Clock Is Already Running

If you sold a commercial building, a multifamily asset, or a parcel of land and opened a 1031 exchange, two clocks started running the day title transferred: **45 days to identify replacement property in writing**, and **180 days total to close on it**. Both deadlines are calendar days, not business days, and the IRS does not grant extensions for a slow due diligence process, a financing contingency that falls through, or a seller who gets cold feet. Once the 45-day window closes without a valid identification, the exchange is effectively over.

This guide compares two categories of replacement property that commercial real estate, multifamily, and land sellers increasingly evaluate when traditional like-kind real estate cannot be sourced, underwritten, and closed inside that window: the **Delaware Statutory Trust (DST)** and the **direct working interest in oil and gas real property**. Both are recognized paths to satisfying Section 1031. They are not interchangeable, and the differences matter most under time pressure, when the temptation is to default to whichever option is easiest to identify rather than the one that fits the seller's actual goals.

In short: a DST is a packaged, IRS-sanctioned securities offering (Revenue Ruling 2004-86) that converts the seller into a passive beneficial interest holder in a trust that owns real estate, with a sponsor controlling nearly every operating decision. A direct working interest in oil and gas is real property under Revenue Ruling 68-331, structured so the exchanger holds direct ownership rather than a fund unit, and it carries an additional tool that a DST does not: if the exchange still fails, or partial boot remains, the same capital deployed into a working interest can generate an intangible drilling cost (IDC) deduction under IRC Section 263(c) that directly offsets the taxable gain. Both paths can close well inside 180 days. Only one offers a second line of defense if the exchange itself does not go as planned.

⚠ Both deadlines are calendar days — not business days. The IRS grants no extensions for due diligence delays, financing contingencies, or seller hesitation.

What Is Being Compared

This guide evaluates two specific, commonly confused replacement property structures:

Option A: Delaware Statutory Trust (DST) Interests

A legal trust structure, recognized by Revenue Ruling 2004-86, that holds title to real property — often institutional-grade multifamily, net-lease retail, industrial, or self-storage assets — on behalf of multiple beneficial interest holders. Interests are offered as securities, typically through a broker-dealer, to accredited investors.

Option B: Direct Working Interest in Oil and Gas Real Property

An undivided operating interest in the mineral estate, held directly by the exchanger (not through a fund, LP, or LLC that would convert it into personal property for exchange purposes), as recognized under Revenue Ruling 68-331 and its companion ruling, Revenue Ruling 68-226.

This is not a comparison of "real estate versus oil and gas" in the abstract. It is a comparison of two specific, IRS-recognized frameworks for completing a 1031 exchange, each with a different ownership model, a different timeline profile, and a different tax posture if the exchange does not close cleanly.

Seven Evaluation Criteria

Sellers under 45-day and 180-day pressure should evaluate each option against seven factors:

01

Ownership Structure

Do you hold a direct, divided real property interest, or a beneficial interest in a trust or securities offering?

02

Participation Level

Is your role active, with governance rights and operational visibility, or passive, with the sponsor retaining full control?

03

Governance and Control

Who makes operating, financing, and disposition decisions after closing?

04

Timeline Fit

Can the option realistically be identified within 45 days and closed within 180, including diligence, subscription, and funding mechanics?

05

Liquidity and Transfer

How easily can the position be sold, and at what typical discount, if circumstances change?

06

Tax Treatment

Does the structure satisfy like-kind replacement cleanly, and does it offer any additional offset if boot or a failed exchange results in taxable gain?

07

Complexity and Administrative Burden

What ongoing reporting, management oversight, or compliance obligations does the structure impose on the exchanger?

Option A: The Delaware Statutory Trust (DST)

Revenue Ruling 2004-86 established that a beneficial interest in a properly structured DST is treated as a direct interest in real estate for Section 1031 purposes, rather than an interest in a business entity. This ruling is the reason the DST industry exists as a mainstream 1031 replacement option: it gave sponsors a clean, IRS-blessed framework to package institutional real estate into fractional interests that multiple exchangers could use simultaneously to satisfy their own, separate exchanges.

The structure comes with restrictions, commonly referred to in the industry as the **"seven deadly sins,"** that the trustee must observe for the trust to retain its favorable tax status: no new capital contributions once the offering closes, no renegotiation of the terms of existing debt, no reinvestment of sale proceeds (net proceeds must be distributed to beneficial interest holders, who may then execute a new exchange if they choose), reserves held only in short-term instruments, no new leases outside of a very narrow renewal exception, and no capital improvements beyond routine maintenance or legally required work. These restrictions exist because the trust must function as a passive holding vehicle, not an operating business, to preserve the 1031 treatment described in the ruling.

For a seller working against the clock, the DST's primary appeal is **speed and packaging**. Because the sponsor already owns the underlying property before the offering opens, subscribing into a DST can close in a matter of days once diligence is complete, often faster than negotiating and closing a direct real estate purchase. Minimum investments typically range from $100,000 to $250,000, and the offerings are restricted to accredited investors under federal securities law, consistent with their treatment as securities rather than direct property interests.

The trade-off is **control and cost**. Once the exchanger subscribes, the sponsor runs the asset: leasing, capital decisions, refinancing, and the eventual sale timeline. Fee layers are built into the structure at multiple points: an upfront acquisition or organizational cost commonly in the 8 to 15 percent range, ongoing annual asset and property management fees, a disposition fee, and often a promoted interest above a preferred return hurdle. Total fee drag across a typical hold period has been estimated in independent industry analysis at roughly **25 to 35 percent of invested capital** over the life of the investment. Hold periods typically run five to ten years, and if an exchanger needs to exit early, the secondary market for DST interests is thin: resale, when a buyer can be found at all, commonly requires a discount of **20 to 50 percent to book value**, according to industry commentary from 1031-focused advisory practices.

Option B: Direct Working Interest in Oil and Gas Real Property

Revenue Ruling 68-331 holds that an assignment of a working interest in oil and gas properties qualifies as an exchange of like-kind real property under Section 1031, provided the interest is a real property interest under applicable state law. Revenue Ruling 68-226 separately confirmed that a lessee's working interest in oil and gas in place is itself real property. Together, these rulings are the statutory foundation for treating a working interest as eligible 1031 replacement property, separate from (and considerably older than) the DST's 2004 ruling.

The critical structural requirement is that the interest must be held **directly**, not through a limited partnership, LLC, or fund vehicle that would convert it into personal property (a partnership interest) for exchange purposes. Treasury Regulation 1.1031(a)-3 and the state-law real property test govern this classification, and a partnership can preserve direct-ownership treatment for its participants only if it elects out of Subchapter K entirely under Section 761(a), an election most fund structures do not make. This is the structural reason Summit Ventures positions its working interest offerings as direct ownership positions rather than fund units: direct ownership is what keeps the asset inside the like-kind framework Revenue Ruling 68-331 describes.

Unlike a DST, there is no single, packaged industry ruling that gives working interest sponsors the same off-the-shelf securities framework DST sponsors use. Each working interest exchange relies on the underlying real property classification itself, case law, and Treasury Regulation 1.1031(a)-3's state-law test, rather than a dedicated packaged-offering ruling. In practice, this means the identification and closing process centers on the same real property diligence any 1031 exchanger already understands — title, interest type, operating agreement terms — rather than a securities subscription process layered on top of it.

Participation is also structurally different. A working interest owner holds an operating interest subject to the costs and risks of development and production, with governance rights tied to the joint operating agreement rather than a trustee's discretion. This is a materially more active ownership position than a DST beneficial interest, which some sellers moving out of "toilets, tenants, and trash" management may want to understand clearly before proceeding: a working interest replaces property management obligations with a different operational profile tied to the energy asset, not with zero involvement.

Tax Boot Mitigation: What Happens When the Exchange Does Not Close Cleanly

Every 1031 exchange carries a scenario the identification deadline makes more likely than sellers expect: **partial failure**. A seller identifies replacement property within 45 days, but the equity or debt does not fully trade up, cash is left over after closing (boot), or the 180-day window closes before a suitable property can be acquired at all. In either case, some or all of the deferred gain becomes taxable in the year of the sale, along with depreciation recapture and, where applicable, the net investment income tax (NIIT).

This is where the two structures in this guide diverge most sharply for a seller who is already under time and tax pressure. A DST interest, like any other qualifying replacement property, can absorb exchange proceeds and help satisfy the equal-or-greater value and debt-replacement requirements that avoid boot in the first place. But once an exchange has already generated boot, or has already failed outright, a DST offers no additional tax tool specific to that outcome. **The gain is the gain.**

A direct working interest carries a second mechanism entirely independent of the exchange's success or failure: the **IRC Section 263(c) election to currently deduct intangible drilling costs (IDC)**. IDCs, which include labor, fuel, site preparation, and other non-salvageable drilling expenses, may be elected for current deduction rather than capitalized and depreciated over time. For a seller who has already recognized taxable boot, or who runs out the 180-day clock and converts the entire deferred gain into a current-year tax event, deploying new capital directly into a working interest and electing to currently deduct the IDC portion creates an offsetting deduction against ordinary income in the same tax year the gain is recognized. The deduction is not a 1031 mechanic at all. It is a separate, independent tax tool under Section 263(c) that applies whether or not an exchange was ever attempted, which is precisely why it functions as a backstop rather than a replacement for careful exchange planning.

Qualification #1: IDC Allocation

The exact portion of a given investment that qualifies as an intangible cost eligible for current deduction depends on the specific drilling program, the allocation between intangible and tangible costs, and the taxpayer's individual facts. No flat or universal deductibility percentage should be assumed for any specific offering.

Qualification #2: IRC Section 469(c)(3) Structure

The working interest must generally be held directly or through an entity that does not limit the holder's liability (such as a general partnership interest) for the deduction to be treated as offsetting active or portfolio income rather than being trapped as a passive loss. An LP or LLC structure that shields the holder from liability will typically forfeit this treatment. This is a second, independent reason direct holding structure matters, beyond the 1031 real-property classification itself.

A tax professional should confirm both qualifications before any capital is committed.

Side-by-Side Comparison

Category	Delaware Statutory Trust (DST)	Direct Working Interest
Ownership	Beneficial interest in a trust; indirect real estate exposure	Direct, undivided real property interest under state law
Governing Authority	Revenue Ruling 2004-86	Revenue Ruling 68-331, Revenue Ruling 68-226, Treas. Reg. 1.1031(a)-3
Participation	Passive; sponsor/trustee controls all operating decisions	Active; governed by joint operating agreement, direct working interest owner rights
Governance and Control	Limited to trustee-permitted actions (the seven restrictions)	Operating agreement defines voting, cost, and decision rights
Timeline Fit	Fast subscription once diligence is complete; sponsor already owns the asset	Diligence centers on title and interest type; closing mechanics track standard real property practice
Liquidity	Thin secondary market; resale discounts commonly 20 to 50 percent when a buyer exists at all	No public secondary market; intended as a longer-term direct holding
Tax Treatment (1031)	Qualifies as like-kind real property per Rev Rul 2004-86, subject to the seven restrictions	Qualifies as like-kind real property per Rev Rul 68-331, subject to direct-holding requirement
Tax Treatment (Boot/Failed Exchange)	No independent deduction mechanism beyond standard real estate depreciation	IRC 263(c) IDC election can offset taxable boot or failed-exchange gain in the same tax year
Exposure and Limitations	Sponsor inflexibility; cannot add capital, refinance, or reinvest proceeds mid-hold	Direct exposure to drilling and operating outcomes; requires direct or general-partnership holding to preserve 469(c)(3) treatment
Complexity	Securities subscription process; accredited investor eligibility required	Real property and operating agreement diligence; direct title and IDC election coordination with a tax professional
Minimum Commitment	Typically $100,000 to $250,000	Varies by program and interest size

Advantages and Limitations

DST

DST Advantages

- Established, IRS-recognized packaged framework
- Fast subscription timeline once underwriting is complete
- Professional third-party asset management
- Well suited to sellers who want to fully exit property-level decision making

DST Limitations

- Fee layers across acquisition, management, and disposition can meaningfully reduce net proceeds over a multi-year hold
- Limited to passive participation with no governance input
- Thin resale market if circumstances change
- No additional tax tool if boot or a failed exchange results in a taxable event

WORKING INTEREST

Working Interest Advantages

- Satisfies like-kind replacement under a long-standing, separate line of revenue rulings
- Direct holding preserves both the real property classification and the IRC 469(c)(3) active-income treatment
- The IRC 263(c) IDC election provides an independent tax offset usable even outside a successful exchange
- Diversifies concentration away from traditional real estate into a different asset class and cash flow profile

Working Interest Limitations

- No single packaged industry ruling comparable to Rev Rul 2004-86, so diligence focuses on the specific interest's title, operating agreement, and direct-holding structure
- Requires closer coordination with a tax professional to confirm the direct-holding and election mechanics apply to the specific offering and the seller's individual facts
- Operational exposure tied to drilling and production outcomes rather than a leased real estate cash flow profile

Best-Fit Scenarios

DST Is the Better Fit When...

You have fully decided you want out of active real estate decision making altogether, you meet accredited investor status, you are comfortable with a multi-year illiquid hold and sponsor-controlled governance, and your primary goal is completing a clean, full-value exchange without any expectation of boot.

Working Interest Is the Better Fit When...

You want to retain a direct, governed ownership position rather than a passive trust interest, you are evaluating diversification away from "toilets, tenants, and trash" into a different real asset class, and critically, you are concerned you may not fully satisfy the exchange — whether due to identification timing, financing gaps, or a value mismatch. For this last group, the Section 263(c) IDC mechanism offers a planning option a DST structurally cannot provide.

Decision Guidance

1 Start with the Calendar, Not the Asset Class

If fewer than 45 days remain and no replacement property has been identified in writing, both options require immediate action: a DST requires completed broker-dealer subscription paperwork and accredited investor verification, and a direct working interest requires confirmed title and direct-holding documentation. Neither can be identified informally.

2 Separate the Exchange Question from the Tax Question

If the goal is a clean, full-value exchange with no appetite for ongoing operating involvement, evaluate DST inventory against your specific debt and equity replacement requirements. If there is meaningful risk of boot, a value mismatch, or an outright failed exchange given the time remaining, evaluate a direct working interest allocation specifically for its 263(c) IDC offset potential, independent of whether the 1031 itself succeeds.

3 Confirm Structure Before Confirming the Asset

A working interest only preserves its like-kind and active-income treatment when held directly (or through a 761(a) electing partnership), not through a standard LP or LLC fund interest. A DST only preserves its 1031 treatment when the trustee observes the seven restrictions. Verify both with your qualified intermediary and tax advisor before funds move, not after.

Questions for Your Advisory Team

1. How many days remain in our 45-day identification window, and has a written identification been filed for any option under consideration?
2. Is the working interest or DST interest being offered structured for direct holding, or through an LP/LLC/fund vehicle that could affect 1031 and IRC 469(c)(3) treatment?
3. What is our realistic exposure to boot given current relinquished property value, debt payoff, and the replacement property or interest under consideration?
4. If boot or a failed exchange appears likely, what portion of a working interest allocation could qualify for a Section 263(c) IDC election, and what does that mean for our specific tax position this year?
5. What are the full fee layers (acquisition, management, disposition, promote) associated with any DST interest under consideration, and how do they compare to the direct costs of a working interest position?
6. What governance rights, reporting, and operating agreement terms apply to a working interest position, and how do they compare to the passive structure of a DST?
7. What is our realistic exit timeline and liquidity expectation for each option, and how does that align with our broader capital plan?

Sources, References, and Next Steps

Sellers working against a 45-day identification clock rarely have the luxury of exploring every replacement property category in depth, which is exactly why understanding the structural differences between a DST and a direct working interest before the clock starts — or as early into it as possible — matters more than it may first appear. Both are legitimate, IRS-recognized paths to satisfying Section 1031. Only one offers a defined, independent tax mechanism for the scenario every exchanger hopes to avoid but should still plan for: a partial or failed exchange that leaves taxable gain on the table. Reviewing both options with a qualified intermediary and a tax professional who understands the direct-holding requirements behind Revenue Ruling 68-331 and IRC Sections 263(c) and 469(c)(3) is the next concrete step toward a decision that fits both the calendar and the full range of tax outcomes still in play.

Rev. Ruling 2004-86

IRS holding establishing DST beneficial interests as 1031-eligible replacement property, subject to the seven structural restrictions on trustee activity.

Rev. Ruling 68-331

Foundational IRS ruling treating an assignment of working interest in oil and gas properties as a like-kind exchange of real property.

Rev. Ruling 68-226

Companion ruling confirming a lessee's working interest in oil and gas in place constitutes real property.

Treas. Reg. 1.1031(a)-3 & IRC §761(a)

Governing the state-law real property test and the partnership election mechanism required to preserve direct-ownership treatment.

IRC §263(c)

Statutory basis for the current deduction election for intangible drilling costs.

IRC §469(c)(3)

Governs the active-income treatment of working interests held directly or through non-liability-limiting structures.

Additional sources informing this guide include Treasury Regulation 301.7701-4(c) (partnership-reclassification risk underlying the DST's seven restrictions); Realized1031 industry analysis on DST structural restrictions and sponsor limitations; First American Exchange Company DST versus tenancy-in-common structural comparison including Revenue Procedure 2002-22 ownership caps; EisnerAmper analysis of DST investor tax reporting mechanics including grantor trust letter treatment; independent 1031 advisory industry analysis on DST fee structure and total fee drag estimates; Anchor1031 and Phoenix Strategy Group commentary on DST secondary market resale discount ranges and hold period data; and Bonaventure and industry DST market-size reporting on fundraising volume figures for recent reporting years.

> Ready to evaluate your specific exchange situation? Summit Ventures works with commercial, multifamily, and land sellers navigating the 45-day clock — helping you understand whether a DST, a direct working interest, or a combination of both fits your timeline, tax position, and capital goals.

Connect with Summit Ventures Today | **Learn More About Working Interest Exchanges**