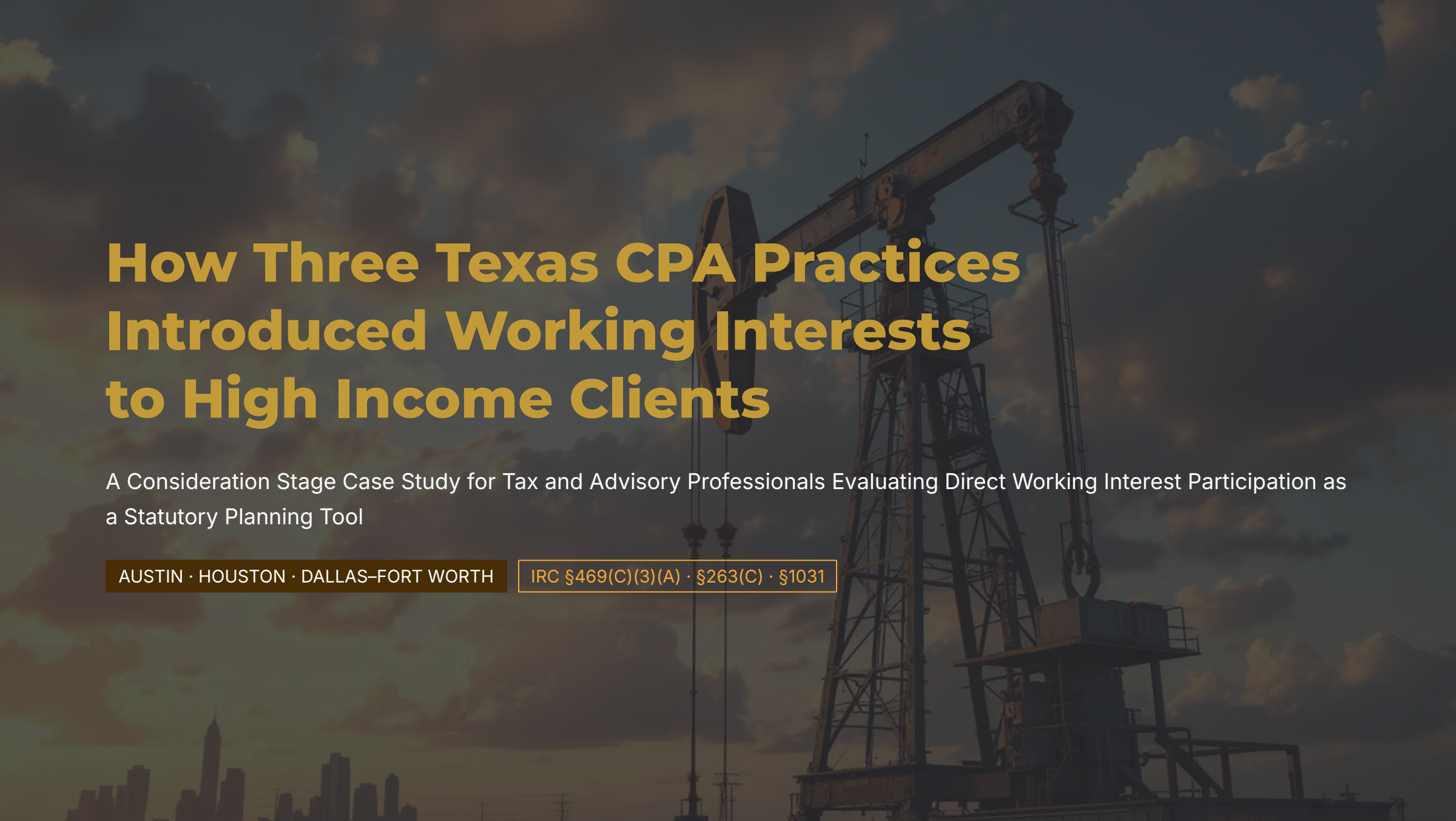


How Three Texas CPA Practices Introduced Working Interests to High Income Clients

A Consideration Stage Case Study for Tax and Advisory Professionals Evaluating Direct Working Interest Participation as a Statutory Planning Tool

AUSTIN · HOUSTON · DALLAS–FORT WORTH

IRC §469(C)(3)(A) · §263(C) · §1031

Case Classification & At a Glance Summary

Case type: Anonymized, composite execution profile. The three practice scenarios below are illustrative and compiled from common fact patterns encountered across CPA, Registered Investment Advisor, Qualified Intermediary, business broker, estate planning attorney, and commercial real estate broker engagements. No individual client, firm, or financial outcome described here is an actual testimonial, and no dollar figures or deduction percentages are stated as guaranteed results.

Industry: Public accounting and wealth advisory, serving high income individual and business owner clients in Austin, Houston, and Dallas Fort Worth, Texas.

Coordinating professionals represented: Three CPA practices acting as the lead advisor of record, with supporting roles played by a Registered Investment Advisor, a Qualified Intermediary, a business broker and M&A advisor, an estate planning attorney, and a commercial real estate broker, each engaged at the point where their discipline intersected with the client's tax position.

Statutory Framework Referenced

- IRC §263(c) & Treas. Reg. 1.612-4 — Intangible drilling cost election
- IRC §469(c)(3)(A) — Working interest exception to passive activity
- IRC §465 — At risk limitation
- IRC §461(h) — Economic performance, 90-day drilling exception
- IRC §57(a)(2)(A) — Excess IDC as AMT preference item
- IRC §§611 & 613A — Percentage depletion
- Rev. Rul. 68-331 & 78-135 — Like kind classification
- Treas. Reg. 1.1031(k)-1 — Exchange period mechanics

Participant Profiles, Triggers & Situations

🏙️ Austin Practice

A mid-sized CPA firm serving corporate executives and equity-compensated professionals identified a recurring year-end pattern among three clients: W-2 compensation, vested restricted stock, and year-end bonus payouts were compressing into a single tax year and pushing clients into the top marginal bracket with little remaining room in standard deferral vehicles. Each client already worked with a Registered Investment Advisor on portfolio allocation, but the advisor's toolkit was built around diversification and risk-adjusted return, not around a statutory mechanism for reducing current year ordinary income. The firm's existing playbook — maximizing retirement plan contributions, timing charitable contributions, harvesting losses — had already been exhausted for these clients in prior years.

🛢️ Houston Practice

A CPA firm with a concentration in business owner clients was engaged by a client completing the sale of a closely held services company. The transaction, sourced and negotiated with the help of a business broker and M&A advisor, produced a purchase price allocation with a meaningful ordinary income component (recapture and a consulting/non-compete payment taxed at ordinary rates) layered on top of the capital gain portion of the deal. The client's CPA recognized that the ordinary income slice of the transaction would not receive the more favorable long-term capital gains treatment applied to the rest of the proceeds, and the client had limited remaining basis or loss carryforwards to absorb it.

🏗️ Dallas–Fort Worth Practice

A CPA firm serving commercial real estate investors was brought in mid-transaction after a client's Section 1031 exchange began to narrow. The client, working with a commercial real estate broker and a Qualified Intermediary, had identified three replacement properties within the 45-day identification window required under Treas. Reg. 1.1031(k)-1, but two fell out of contract as financing and inspection issues emerged. The estate planning attorney involved in the client's broader wealth transfer plan was also monitoring the exchange, since the replacement property was intended to remain in the client's estate for multi-generational planning purposes. With the 180-day exchange period continuing to run, the CPA needed to understand what qualifying replacement property options remained available on short notice.

The Challenge: Four Non-Negotiable Decision Criteria

Across all three practices, the underlying professional challenge was the same. Each CPA needed a planning mechanism that met four non-negotiable criteria before it could be brought to a client:

Codified Statutory Basis

It had to rest on a codified statutory provision rather than an informal or aggressively marketed planning technique, so that the firm's recommendation would hold up under IRS scrutiny and under the CPA's own professional standards of practice.

Clean Documentation

It had to produce documentation — K-1 reporting, cost allocation records, and where relevant a tax opinion letter — that the CPA could independently review and that would reconcile cleanly with the client's broader return, rather than generic fund-level reporting that left the CPA guessing at classification.

Correct Structure from the Outset

It had to be structured correctly from the outset, since several of the relevant Code provisions — most notably IRC 469(c)(3)(A) — depend entirely on how the interest is held, not merely on the type of asset.

Explainable to All Advisors

It had to be explainable to the client's other advisors — the RIA, the business broker, the estate attorney, the CRE broker, and the Qualified Intermediary where applicable — in terms those professionals could independently evaluate within their own discipline.

Options Considered & The Approach Chosen

Each CPA practice considered a short list of alternatives before arriving at a direct working interest in domestic oil and gas development as the common thread across all three situations.

Alternatives Evaluated & Set Aside

Standard deferral and timing strategies — additional retirement plan contributions, installment sale elections, qualified opportunity fund deferral — were evaluated first in each case and either had already been used, did not fit the client's liquidity needs, or addressed only the timing of the tax liability rather than offering a current year, statutorily supported offset against active income.

Passive real estate and syndicated fund structures were considered and set aside for the Austin and Houston scenarios specifically because losses generated through a limited partnership or liability-limiting LLC interest are passive losses under IRC Section 469, generally usable only against other passive income, not against the W-2 income, bonus income, or ordinary deal proceeds the clients needed to offset.

The Mechanism That Met All Four Criteria

A **direct working interest**, held by the client individually or through an entity that does not limit the client's liability, was identified as the mechanism that met all four decision criteria.

Under IRC Section 469(c)(3)(A), a working interest held this way is explicitly excluded from the passive activity definition, regardless of whether the client materially participates in operations — which allowed the resulting IRC Section 263(c) intangible drilling cost deduction to offset active and ordinary income directly.

For the Dallas–Fort Worth scenario, the same direct holding requirement did double duty: Revenue Ruling 68-331 classifies an operating working interest in a producing oil and gas lease as an interest in real property, making it potentially eligible like-kind replacement property for a Section 1031 exchange, while Revenue Ruling 78-135 confirms that a partnership interest itself does not qualify — reinforcing why the form of ownership mattered as much as the underlying asset.

Each CPA brought the structure to **Summit Ventures'** entrepreneurial joint venture platform as the vehicle through which the client could become a direct working interest owner and active JV member in a specific development program, rather than a passive fund investor.

Implementation: Five Steps Across All Three Practices

1 Technical Briefing & Structure Review

Each CPA engaged Summit Ventures' advisory support team for a technical briefing on the specific program under consideration, reviewing the authorization for expenditure, the intangible versus tangible cost split documented for the well, and the entity structure confirming direct, non-liability-limiting ownership required to preserve the IRC 469(c)(3)(A) exception.

2 IRC §461(h) Timing Confirmation

For the Houston and Austin clients, the capital contribution and well spud timing were reviewed against IRC Section 461(h) economic performance rules, which generally require drilling to commence within 90 days of a year-end capital contribution in order for the related intangible drilling costs to be deductible in the year paid — a timing detail each CPA confirmed directly with Summit's operations team before advising the client to proceed before year end.

3 Tax Opinion Letter for the 1031 Exchange

For the Dallas–Fort Worth client, the estate planning attorney and Qualified Intermediary jointly reviewed whether the working interest met the direct ownership standard required by Revenue Ruling 68-331 and 78-135, and a tax opinion letter was obtained to support the position within the remaining exchange period, with the CRE broker continuing to search for a traditional replacement property in parallel rather than in place of the working interest option.

4 At Risk Basis & AMT Modeling

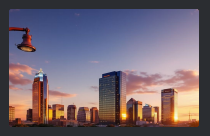
Each CPA independently verified the IRC Section 465 at-risk basis calculation (limited to cash actually contributed, since nonrecourse debt does not increase at-risk basis for this purpose), and flagged the IRC Section 57(a)(2)(A) alternative minimum tax preference rule, under which excess intangible drilling costs are a preference item only to the extent they exceed 65 percent of the client's net income from oil, gas, and geothermal properties for the year — a threshold each firm modeled against the client's specific facts rather than assuming it would or would not apply.

5 K-1 Reconciliation & Depletion Documentation

Summit Ventures delivered Schedule K-1 reporting coded to reflect the nonpassive, direct working interest classification under IRC Section 469(c)(3)(A), which each CPA reconciled against the client's Form 1040 as part of normal return preparation, alongside documentation supporting the ongoing IRC Sections 611 and 613A percentage depletion allowance available once the well reaches production.

Explanation & Outcomes by Practice

The outcomes below are presented as illustrative, not as verified financial results, and no specific deduction amount, return figure, or performance outcome is stated as a guaranteed or typical result of participation.



Austin Practice

The CPA was able to present the client's Registered Investment Advisor with a mechanism that operated independently of the advisor's portfolio allocation work, since the working interest capital contribution and resulting IRC 263(c) deduction addressed the ordinary income side of the client's return rather than competing with the RIA's asset allocation strategy. The CPA and RIA were able to coordinate so that each professional's recommendation remained within their own area of licensure and expertise.



Houston Practice

The business broker and M&A advisor's role concluded at closing, while the CPA used the direct working interest structure to address the ordinary income component of the sale proceeds in the same tax year it was recognized, using a statutory provision rather than a deferral technique that would have simply postponed the liability.



Dallas–Fort Worth Practice

The client's 1031 exchange ultimately proceeded using a combination of a traditional replacement property sourced by the CRE broker and a direct working interest position supported by the tax opinion letter obtained through the estate planning attorney's review, illustrating that the working interest option functioned as a documented contingency rather than the client's sole exchange strategy.

Metrics Summary & Representative Perspectives

Practice	Decision Criterion	Coordinating Professional	Documentation Produced
Austin	Current year active income offset without disturbing existing portfolio allocation	Registered Investment Advisor	K-1 coded nonpassive under 469(c)(3)(A), AFE cost split, year-end timing memo referencing 461(h)
Houston	Offset for the ordinary income component of a business sale	Business broker and M&A advisor	K-1 coded nonpassive under 469(c)(3)(A), at-risk basis worksheet under IRC 465
Dallas–FW	Qualifying replacement property option during a narrowing 1031 identification window	Qualified Intermediary, CRE broker, estate planning attorney	Tax opinion letter referencing Rev. Rul. 68-331 and 78-135, identification filing under Treas. Reg. 1.1031(k)-1

"My client's RIA was candid that diversification and tax offset are two different jobs. Once the working interest was structured as a direct holding rather than a fund interest, I could show the client exactly why the deduction applied against his W-2 income under Section 469(c)(3)(A), and the K-1 we received matched that classification without any reconciliation back and forth."

— Composite reflection, Austin practice

"The business broker's job was done at closing. Mine was just starting. The ordinary income piece of that deal needed a current year answer, not another deferral mechanism, and the documentation Summit provided let me defend the position the same way I would defend any other statutory election."

— Composite reflection, Houston practice

"The Qualified Intermediary and I were watching the clock together. Having a tax opinion letter in hand on the real property classification question, rather than relying on a verbal assurance, is what let the estate attorney sign off on including it as an identified option."

— Composite reflection, Dallas–Fort Worth practice

Key Takeaways & Questions for Advisors

Assumptions & Key Takeaways

This case study assumes that each client met applicable investor qualification standards, that each working interest was held directly or through a non-liability-limiting entity as required by IRC 469(c)(3)(A), and that each firm's advice was given alongside, not in place of, the client's own independent tax and legal counsel.

Structure Determines the Exception

The IRC 469(c)(3)(A) working interest exception is a function of *how* the interest is held, not simply what the interest is — which makes the entity structure review a required step in every engagement rather than an afterthought.

One Structure, Multiple Statutory Purposes

A direct working interest can serve more than one statutory purpose for the same client profile. The same direct holding structure that supports the 469(c)(3)(A) active income offset is also the structure Revenue Ruling 68-331 and 78-135 require for 1031 like-kind treatment.

Timing and Documentation Are Not Optional

Timing provisions such as IRC 461(h) and documentation requirements such as a tax opinion letter are not optional details. They are the difference between a position the CPA can defend and one that invites inquiry.

Multi-Disciplinary Coordination Is the Model

Bringing a working interest option to a client works best as a coordinated, multi-disciplinary process — with the CPA, RIA, business broker, estate attorney, Qualified Intermediary, and CRE broker each confirming the aspects of the transaction within their own expertise rather than any single advisor being asked to vouch for the entire structure.

Questions for Advisors to Consider

Does the engagement letter and entity documentation clearly establish direct ownership or ownership through a non-liability-limiting entity, sufficient to support the IRC 469(c)(3)(A) classification?

Has the intangible drilling cost and tangible cost split for the specific program been confirmed against the authorization for expenditure, rather than assumed from an industry range?

For clients near the alternative minimum tax threshold, has the IRC 57(a)(2)(A) 65 percent of net oil and gas income calculation been modeled against the client's specific facts?

Where a 1031 exchange is in progress, has a tax opinion letter been obtained addressing Revenue Ruling 68-331 and 78-135 before the identification window closes, rather than after?

Does the K-1 reporting the client will receive clearly code the position as nonpassive and reconcile cleanly with the firm's own workpapers, or will the firm need to perform additional reclassification work at filing time?

Which of the client's other advisors — RIA, business broker, estate attorney, CRE broker, Qualified Intermediary — need to be briefed on the structure before it is presented to the client, and in what order?

Sources, References & Next Steps

Sources & References

- 26 U.S.C. §263(c) and Treas. Reg. 1.612-4 — Intangible drilling and development cost election
- 26 U.S.C. §469(c)(3)(A) — Working interest exception to passive activity classification, Cornell Legal Information Institute
- 26 U.S.C. §465 — At-risk limitation on allowable losses
- 26 U.S.C. §461(h) — Economic performance requirement and the 90-day drilling exception as applied to intangible drilling costs
- 26 U.S.C. §57(a)(2)(A) — Excess intangible drilling costs as a tax preference item, 65 percent of net oil, gas, and geothermal income threshold
- 26 U.S.C. §§611 and 613A — Percentage depletion for independent producers
- Revenue Ruling 68-331, 1968-1 C.B. 352 — Classification of an operating oil and gas working interest as real property for purposes of Section 1031
- Revenue Ruling 78-135 — Limitation confirming that a partnership interest itself does not qualify for Section 1031 like-kind treatment
- Treas. Reg. 1.1031(k)-1 — Identification and exchange period requirements for deferred like-kind exchanges
- BassEXP — K-1 Tax Reporting for Oil and Gas Investors, and Section 469 Working Interest: Active vs. Passive
- Anchor1031 — 1031 Exchange and Oil and Gas Investments, confirming the role of a tax opinion letter in supporting a working interest exchange position

Across these three Texas practices, the common thread was not a single client profile or a single transaction type, but a recurring professional need: a statutory mechanism that a CPA could defend on its own terms, documented in a way that reconciled cleanly with existing return preparation workflows, and coordinated with the other professionals already serving the client. Summit Ventures' role in each case was limited to its own discipline — structuring and operating the working interest and delivering the documentation each advisor needed to do their own job with confidence — leaving the tax position, the exchange strategy, and the overall financial plan where they belong, with the client's own professional advisors.

Ready to Evaluate Direct Working Interests for Your Clients?

Summit Ventures provides CPA practices, RIAs, Qualified Intermediaries, estate planning attorneys, business brokers, and commercial real estate brokers with the technical briefings, authorization for expenditure documentation, and K-1 reporting infrastructure needed to evaluate and implement direct working interest participation as a statutory planning tool.

Connect with Summit Ventures' advisory support team to request a program overview, review entity structure requirements under IRC §469(c)(3)(A), and determine whether a direct working interest is appropriate for your client's specific tax position.

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