

Working Interest Ownership vs. Passive Real Estate vs. Securities

A Decision-Stage Comparison of Ownership Structure, Tax Treatment, Liquidity, and Governance for Founders Navigating a Business Exit, Recapitalization, or Large Owner Distribution

DECISION GUIDE

FOR EXITING OPERATORS

The Problem Every Exiting Operator Faces

A business exit, a PE recapitalization, or a large owner distribution creates a specific and narrow problem: a concentrated pool of capital, a compressed tax year, and a short window to make a deployment decision before the liability is locked in. Most exiting operators default to one of three paths. They hold public securities because a wealth advisor recommends diversification. They buy passive real estate because it is familiar and tangible. Or they explore working interest ownership in oil and gas because someone mentioned a tax deduction in passing.

Few founders evaluate these three paths side by side, using the same criteria: who controls the asset, how the tax code actually treats the structure, how quickly capital can move, and how much operational complexity the owner is signing up for. This guide builds that direct comparison. It is written for operators who are used to running a business, not managing a portfolio, and who want to understand the mechanics before a CPA or wealth manager presents a recommendation.

> The core question this guide answers: when a founder has just converted years of enterprise value into a single tax event, which ownership structure actually gives them control, a statutory tax outcome rather than an income-capped one, and a way to redeploy capital into a real, operating asset rather than a paper claim on someone else's balance sheet.

The short answer, developed in detail below: working interest ownership is the only one of the three structures where the tax treatment attaches to how the activity is classified under the Internal Revenue Code, not to the owner's income level, hours worked, or holding period. Passive real estate and public securities both carry real advantages, but both are constrained by phase-outs, hour tests, or entity-level taxation that working interest ownership does not share. Each is examined on its own terms below before the comparison table and decision framework.

What Is Compared

This guide evaluates three distinct ownership structures available to a founder redeploying exit or distribution proceeds:

Working Interest Ownership

Direct or entity-held participation in an oil and gas drilling and production program, where the owner holds an actual operating interest in the well and associated lease, governed by a joint operating agreement (JOA) and an authorization for expenditure (AFE) that specifies cost allocation before capital is committed.

Passive Real Estate

Ownership of rental or commercial property, whether directly held, syndicated through a limited partnership, or structured as a Delaware Statutory Trust, where income and losses are treated under the Internal Revenue Code's passive activity rules.

Public Securities

Equities, bonds, mutual funds, or ETFs held in a brokerage account, including concentrated positions in a single sector, diversified index exposure, or fixed income instruments.

Each structure is evaluated against the same five criteria: ownership and control, tax treatment, liquidity and time horizon, diversification and concentration exposure, and operational or administrative complexity.

Evaluation Criteria: Defining the Terms

Before comparing the three structures, it helps to define the terms precisely, because marketing language in this space frequently blurs them.

1 Ownership and Control

Whether the capital contributor holds a direct, title-bearing interest in a physical asset, or an indirect interest in a pooled vehicle managed by a third party. A working interest owner holds an actual interest in the minerals and the well. A real estate syndication limited partner or a mutual fund shareholder holds a claim on the performance of a vehicle managed by someone else.

2 Tax Treatment

How gains, losses, and deductions flow to the owner, and specifically whether the structure is governed by the passive activity loss rules under Internal Revenue Code Section 469, or is statutorily excluded from them.

3 Liquidity and Time Horizon

How quickly the position can be converted back to cash and what holding period the structure realistically requires to perform as intended.

4 Diversification and Concentration Exposure

How much of the owner's capital is tied to a single issuer, sector, or geographic market, and whether that exposure is correlated with the operator's prior business.

5 Complexity

The ongoing administrative, reporting, and decision-making burden the owner carries after capital is committed, including tax filing complexity and the degree of governance participation available to the owner.

Option A: Working Interest Ownership

A working interest is a direct, operating participation in an oil and gas lease. Treasury Regulation 1.612-4(a) defines the operator holding this interest as *"one who holds a working or operating interest in any oil and gas property, either as a fee owner or under a lease or any other form of contract granting working or operating rights."* That single definition is the hinge for everything else that follows, because it describes an owner of an operating asset, not a limited partner in a fund.

Tax Treatment: The Statutory Advantage

Tax treatment is where working interest ownership diverges most sharply from the other two options. Internal Revenue Code Section 263(c), read together with Treasury Regulation 1.612-4, allows the owner to elect to deduct intangible drilling costs (IDC) in the year incurred rather than capitalizing them. IDC covers non-salvageable costs such as labor, fuel, drilling mud, chemicals, site preparation, and hauling. Tangible costs, including casing, wellhead equipment, and tanks, are capitalized and depreciated, generally under a 7-year MACRS schedule and, where applicable, under current bonus depreciation rules. The specific allocation between intangible and tangible costs depends on the well's engineering design and the authorization for expenditure (AFE) for that specific project, so it varies by well and should be confirmed with a qualified CPA rather than assumed from a general industry range.

Section 263(c) governs deduction timing and classification. A separate and more consequential provision determines whether that deduction can offset active income at all. Internal Revenue Code Section 469(c)(3)(A) excludes working interests from the passive activity loss rules entirely, stating that passive activity *"shall not include 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."* This is a classification-based exception, not an income-based one. It carries no adjusted gross income phase-out and no hours-of-participation test, provided the interest is held directly or through a liability-unlimited entity such as a general partnership, rather than through an LLC or LP that shields the owner from liability. That last condition is the detail most competitor marketing in this space omits, and it is the single structural decision that determines whether a working interest behaves like a statutory exception or defaults back to ordinary passive treatment.

> ⚠ The Section 469(c)(3) exception applies only when the interest is held directly or through an entity that does not limit the taxpayer's liability. Holding through an LLC or LP wrapper can eliminate this benefit entirely.

Three Additional Mechanics for Diligence

First, the at-risk rules under Internal Revenue Code Section 465 limit deductible losses to the owner's cash contribution plus any recourse debt actually at risk, so non-recourse financing does not expand the deductible basis. Second, excess intangible drilling costs can become an alternative minimum tax preference item under Section 57(a)(2), but only above a 65 percent-of-net-oil-and-gas-income threshold for independent producers, meaning most working interest participants with modest IDC relative to production income are unaffected. Third, once a well produces, ongoing percentage depletion under Sections 611 and 613A allows a 15 percent deduction against gross income from the property, with no cost-basis limitation, unlike real estate depreciation recapture.

Liquidity and Governance

Liquidity is the honest tradeoff. A working interest is an operating asset, not a security with a daily quote. Capital is committed through the drilling, completion, and production life of the well, and the owner should plan for a multi-year operational horizon rather than an intraday exit. Governance, however, works in the owner's favor: the joint operating agreement grants the working interest owner a defined voice in major operational decisions, visibility into well-level cost reporting, and an actual title interest in the lease, which is a materially different participation model than a limited partner's position in a blind-pool fund.

Option B: Passive Real Estate

Passive real estate remains the most familiar alternative for exiting operators, largely because the asset is tangible and the mechanics of rent, depreciation, and appreciation are widely understood.

The Phase-Out Problem

Tax treatment here is governed by the default passive activity loss rules under Section 469, with one narrow carve-out. IRS Publication 925 describes a special allowance of up to $25,000 in losses that active participants can deduct against other income, phased out 50 cents per dollar of modified adjusted gross income above $100,000, and eliminated entirely at $150,000 MAGI.

For an exiting operator who has just realized a large capital gain or distribution, that phase-out is typically fully exhausted in the same tax year the loss might otherwise be useful. To escape the passive loss limitation entirely, the owner must qualify as a real estate professional, which requires more than 750 hours of service in real property trades during the year and more than half of the owner's total personal service time spent in those trades — a bar that is structurally difficult for an operator who is also running or just exited an operating business.

Sale Treatment and 2026 Market Context

On a sale, gain attributable to prior depreciation is taxed as unrecaptured Section 1250 gain, capped at a 25 percent federal rate — a materially higher rate than the long-term capital gains ceiling. The remaining gain is taxed at ordinary long-term capital gains rates. For property placed in service after January 19, 2025, the One Big Beautiful Bill Act made 100 percent bonus depreciation under Internal Revenue Code Section 168(k) permanent, reversing the prior phase-down schedule, which is a genuine and currently available benefit for qualifying property.

Market conditions in 2026 also matter to the comparison. Commercial real estate cap rates currently sit near 5.2 percent for multifamily and industrial assets, 6.4 to 6.9 percent for retail, 7.4 percent for office, and 8.5 percent for hospitality, and the CBRE 2026 Cap Rate Survey projects only a 5 to 15 basis point compression for the year, meaning returns in this cycle are being driven primarily by income rather than appreciation.

Liquidity in direct or syndicated real estate is slow by design: closings, lender underwriting, and partnership lock-up periods typically measure in months to years, not days. Governance for a limited partner or Delaware Statutory Trust investor is usually minimal; major decisions rest with the sponsor or trustee, not the capital contributor.

Option C: Public Securities

Public securities, whether individual equities, bonds, or diversified funds, offer the most liquidity of the three structures and require the least ongoing administrative attention.

Tax Treatment

Gains on securities held more than one year are taxed at long-term capital gains rates: 0% up to ~$49,450 for single filers, 15% up to ~$545,500, and 20% above that, with a further 3.8% net investment income tax under Section 1411 — producing a top effective federal rate near 23.8% on qualified income. C-corporation dividends are taxed twice: once at the 21% corporate level, and again at the shareholder level, up to roughly 40.8% effective on non-qualified dividend income. There is no equivalent to Section 263(c) or working interest percentage depletion available to a passive securities holder.

Diversification: Scrutinize the Claim

Diversification is the most commonly cited advantage of securities, and it deserves scrutiny rather than blanket acceptance for an operator who has just exited a concentrated business. Fidelity data shows the S&P 500 has returned approximately 10 percent annually on average since 1957. However, RBC Wealth Management's "Great Narrowing" analysis found that the top 10 stocks in the S&P 500 represented approximately 41 percent of the index's total weight at the end of 2025 — roughly double the concentration of a decade earlier, when the same 10 companies represented closer to 19 percent. An index fund purchased today carries meaningfully more single-name concentration risk than the same index carried ten years ago.

Liquidity and Governance

Liquidity is the clear strength of this option: positions can generally be sold intraday, with settlement in one to two business days. Governance and control are effectively absent for the individual holder; a shareholder votes proxies but does not direct operations, capital allocation, or asset-level decisions, and performance is entirely dependent on management teams and market pricing the owner does not influence.



S&P 500 top-10 stock concentration has more than doubled over the past decade — from approximately 19% in 2015 to approximately 41% at year-end 2025 — directly undermining the diversification argument for index-based securities for founders seeking to reduce concentrated risk. Source: RBC Wealth Management, "The Great Narrowing."

Side-by-Side Comparison

The following table evaluates all three structures across the same six criteria. Use this as a reference framework alongside your CPA and advisory team.

Category	Working Interest	Passive Real Estate	Public Securities
Ownership & Control	Direct, title-bearing operating interest in the lease and well under Treasury Reg. 1.612-4(a); governed by a JOA.	Direct for sole owner; indirect and sponsor-controlled in most syndications and Delaware Statutory Trusts.	Indirect; a claim on enterprise or fund performance with no asset-level control.
Participation & Governance	Defined voice in major decisions through the JOA; visibility into well-level AFE cost reporting.	Limited to voting on major sponsor-proposed actions; day-to-day control rests with sponsor or property manager.	Limited to proxy voting; no operational input.
Tax Treatment	Statutorily excluded from passive loss rules under §469(c)(3)(A) when held directly or through a liability-unlimited entity; IDC election under §263(c); percentage depletion under §611/613A.	Subject to default passive loss rules under §469; $25,000 allowance phased out $100K–$150K MAGI; full bypass requires 750+ hour real estate professional test; unrecaptured §1250 gain at 25% on sale.	Long-term capital gains rates (0/15/20%) plus 3.8% NIIT; C-corp dividends taxed at entity and shareholder level, up to ~40.8% effective on non-qualified dividends.
Liquidity & Time Horizon	Illiquid; capital committed through drilling, completion, and production life — multi-year operational horizon.	Illiquid to semi-illiquid; sale or redemption typically measured in months, often constrained by lock-up terms.	Highly liquid; positions generally sold intraday with 1–2 business day settlement.
Concentration & Diversification	Asset-specific and basin-specific; risk tied to well performance and commodity pricing, not correlated to operator's prior business.	Tied to property type, geography, and sponsor; 2026 cap rates show income, not appreciation, as dominant return driver.	Top 10 S&P 500 names represent ~41% of index weight as of late 2025, up from ~19% a decade earlier.
Complexity & Reporting	K-1 review, AFE and JOA literacy, ongoing CPA coordination on IDC classification, at-risk basis, and depletion; active governance participation.	Schedule E filing, cost segregation or depreciation schedule review; detailed time-log recordkeeping for professional status.	Lowest ongoing administrative burden; standard 1099 reporting with minimal recordkeeping.

Advantages, Limitations & Best-Fit Scenarios

Working Interest: Advantages

Offers a statutory tax position that is not contingent on income level or hours worked, a direct and governed operating interest rather than a passive claim, and a way to redeploy exit proceeds into a tangible, producing asset. Its primary limitation is liquidity: capital is committed for the operational life of the well, and the structure requires genuine diligence on AFE cost allocation, operator track record, and basis tracking.

Best fit: An operator with a current-year active income or distribution event to offset, comfortable holding an illiquid multi-year operating position, who wants direct governance participation. Fits a founder placing surplus corporate capital or a personal distribution before year-end, specifically because the tax treatment is tied to the nature of the activity rather than to income thresholds.

Passive Real Estate: Advantages

Offers a familiar asset class, permanent bonus depreciation on qualifying property, and a hedge against inflation through rent escalation. Its primary limitations for a high-income exiting operator are the narrow, quickly phased-out $25,000 loss allowance, the difficult real estate professional hours test, and a 2026 cap rate environment where compression is minimal and returns depend on operating income rather than appreciation.

Best fit: An owner who already qualifies, or can realistically qualify, for real estate professional status, has a longer runway before needing liquidity, and values the familiarity of a rent-producing asset.

Public Securities: Advantages

Offer unmatched liquidity and the lowest administrative burden of the three. Their limitations are the absence of a statutory deduction mechanism comparable to IDC or depletion, double taxation at the corporate and shareholder level for dividend income, and a documented rise in index-level concentration risk that works against a founder's stated goal of diversifying away from concentrated exposure.

Best fit: The portion of a portfolio that genuinely requires near-term liquidity, or that is intended to track broad market performance with minimal active management — serving as a complement to, rather than a full substitute for, a diversification strategy built on statutorily distinct asset classes.

Most exiting operators are not choosing exclusively among these three. The more defensible approach treats each structure as serving a different function: a portion in securities for liquidity, a portion in real assets for inflation exposure, and a portion in working interest ownership specifically because its tax treatment is classification-based and is not phased out by the same income level that just triggered the exit or distribution event.

Decision Guidance & Next Steps

Four questions determine which structure, or combination of structures, fits a specific situation.

Is capital being deployed this tax year to offset active income?

If the goal is to offset a business distribution or recapitalization gain, the classification-based exception under Section 469(c)(3)(A) becomes the central variable — since it is unaffected by the income phase-outs that limit the real estate allowance.

How concentrated is the owner's net worth already?

How much of the owner's net worth is already concentrated in a single asset or industry determines how much weight diversification into an uncorrelated asset class should carry.

What is the realistic liquidity need over the next 3–5 years?

Working interest and most real estate structures both require patience that public securities do not. The proposed allocation must match the owner's actual liquidity timeline, not a generic model portfolio.

How much direct operational involvement does the owner want?

A joint operating agreement offers a different governance posture than a limited partnership interest or a brokerage account. The owner should be clear on how much visibility and participation they want before committing capital.

About Summit Ventures

Summit Ventures operates as an entrepreneurial joint venture platform built specifically around the working interest structure described in Option A: active JV members and business participants hold a working interest position directly, with governance rights under the joint operating agreement and full visibility into AFE-level cost reporting before capital is contributed. For a founder evaluating where to place year-end surplus corporate capital or a personal distribution, this model is purpose-built to apply the Section 263(c) election and the Section 469(c)(3) classification exception against a current-year active income or distribution event, converting a portion of what would otherwise be a tax liability into direct ownership of a producing asset. The specific IDC-to-tangible-cost allocation, at-risk basis, and depletion treatment for any given well depend on that well's AFE and the participant's individual tax position, and should always be confirmed with a qualified CPA before capital is committed.

Before committing capital to any of these three structures, a founder and their advisory team should work through the following questions:

- Does the capital contributor's holding structure preserve the Section 469(c)(3) exception — meaning is the interest held directly or through an entity that does not limit liability — or will it default to passive treatment through an LLC or LP wrapper?
- What does the specific AFE show for the intangible-versus-tangible cost split on this well, and has that allocation been reviewed against the participant's own basis and at-risk position under Section 465?
- If real estate is part of the plan, does the owner's current or projected hours of personal service realistically clear the 750-hour, majority-time threshold required for real estate professional status, or will the position be capped by the $25,000 phased-out allowance?
- What is the actual liquidity timeline the owner needs over the next three to five years, and does the proposed allocation across working interest, real estate, and securities match that timeline rather than a generic model portfolio?
- How concentrated is the owner's total net worth already, including any remaining equity, earnout, or escrowed proceeds from the business that was sold or recapitalized, and does the proposed diversification genuinely reduce correlation or simply swap one concentrated position for another?
- What governance rights does each structure actually provide, and is the owner comfortable with the degree of operational visibility — or absence of it — that comes with each option?

> Exiting and post-exit founders are rarely short on investment options. What they are short on is a framework that treats tax treatment, governance, liquidity, and concentration as equally important decision variables rather than marketing talking points. Working interest ownership, passive real estate, and public securities each operate under genuinely different sections of the Internal Revenue Code, and genuinely different governance models, and a side-by-side review of the statutory mechanics — not the sales pitch — is the only way to know which structure actually matches a specific exit event, income profile, and time horizon.

Any founder evaluating a working interest position should review the specific AFE, the operator's JOA terms, and their own basis and at-risk position with a qualified CPA before contributing capital. Summit Ventures makes that underlying documentation, and the governance structure behind it, available to prospective business participants as part of a transparent, educational onboarding process, so the decision is made with full visibility into how the structure actually works rather than a simplified summary of it.

Explore Working Interest Ownership with Summit Ventures

Sources and References

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- Internal Revenue Code Section 263(c), election to expense intangible drilling costs.
- Internal Revenue Code Section 469(c)(3)(A), working interest exclusion from passive activity classification, confirmed via Cornell Legal Information Institute statutory text.
- Internal Revenue Code Section 465, at-risk limitation on deductible losses.
- Internal Revenue Code Section 57(a)(2), alternative minimum tax preference treatment for excess intangible drilling costs, independent producer exception.
- Internal Revenue Code Sections 611 and 613A, percentage depletion allowance.
- IRS Publication 925, Passive Activity and At-Risk Rules, $25,000 special allowance and phase-out schedule.
- Internal Revenue Code Section 461(l), excess business loss limitation, 2026 thresholds.
- Real estate professional status requirements, 750-hour and majority personal service time test, Internal Revenue Code Section 469(c)(7).
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