

An Exclusive Briefing for Tax and Financial Professionals on Energy Working Interest Integration

A Strategic Briefing on Direct Working Interest Mechanics, IRC Statutory Tax Treatment, Compliance Documentation, and the Advisor Decision Process

Prepared for CPAs and tax professionals, registered investment advisors, qualified intermediaries, business brokers and M&A advisors, estate planning attorneys, and commercial real estate brokers who advise high-income clients on tax-advantaged structures.

SUMMIT VENTURES

2026 PLANNING REFERENCE

Executive Summary

This briefing exists to give you, as a client-facing advisor, a precise technical understanding of how direct working interest participation in oil and gas development is integrated into a client's tax and liquidity planning under existing Internal Revenue Code provisions. It is not a product pitch. It is a working reference you can bring into a client conversation, a file memo, or a discussion with your own technical team before you ever introduce the structure to a client.

> The core message is narrow and specific: the way a working interest is held — directly or through an entity that does not limit liability — is the single structural fact that determines whether a client's share of intangible drilling cost deductions can offset active income under IRC Section 469(c)(3)(A), and whether the same interest can be analyzed as real property for purposes of Revenue Ruling 68-331.

Advisors who understand this one distinction are positioned to evaluate the category correctly for clients facing year-end income spikes, narrowing 1031 identification windows, or post-sale capital deployment decisions. Advisors who do not understand it risk recommending a structure that fails the very test their client was relying on.

Summit Ventures operates as an entrepreneurial joint venture platform built around direct working interest ownership, standardized K-1 allocation, and documentation designed to support your own independent review, not replace it.

Direct Holding

The single structural fact controlling IDC deductibility against active income under IRC 469(c)(3)(A)

IRC 263(c) Election

Statutory right to expense intangible drilling costs in the year incurred — codified since 1954

Rev. Ruling 68-331

Working interest classified as real property, like-kind to fee real estate for 1031 purposes

Context and Market Environment

High-income clients consistently ask their advisors the same question in slightly different forms: what else can I do, inside the existing tax code, to manage a concentrated income or gain event this year. For most of the professionals reading this briefing, the honest answer has historically been limited to retirement plan deferrals, charitable bunching, or qualified opportunity zone deferral — each with caps, phase-outs, or narrow eligibility windows.

The IRC Section 263(c) election to expense intangible drilling costs has existed in the tax code since 1916 and was codified in its current form in the Internal Revenue Code of 1954. It is not a novel structure or a recent planning technique. It is a long-standing statutory election available to working interest holders, administered through Treasury Regulation 1.612-4, that most advisory practices rarely encounter because direct energy participation has not historically been distributed through channels advisors regularly see.

U.S. Production Outlook

The U.S. Energy Information Administration's Annual Energy Outlook 2026 estimates U.S. crude oil production at approximately **13.6 million barrels per day** in 2025 — a record level — with most outlook cases holding production in the 12.4 to 12.7 million barrel per day range through 2050.

One Big Beautiful Bill Act — July 2025

The One Big Beautiful Bill Act, signed July 2025, made **100 percent bonus depreciation under IRC Section 168(k) permanent** for qualifying property, reversing the prior phase-down schedule. This matters to your clients' broader capital equipment and asset planning conversations even outside of energy-specific decisions, and it is useful context for why tangible drilling cost treatment remains a current topic in 2026 planning discussions.

The Core Challenge Advisors Face

Advisors in this audience face a specific, recurring tension. Your clients bring you real, time-sensitive problems: a bonus or K-1 allocation that spikes taxable income late in the year, a 1031 exchange where identified replacement properties are falling out of contract as the 45-day window closes, or a business sale where proceeds need a home before the next estimated tax payment is due. You want to offer a legitimate answer. But the alternative investment category broadly, including energy, carries a reputational hazard for advisors: recommending a structure that turns out to be non-compliant, poorly documented, or structured in a way that defeats its own stated tax purpose.

> The decision factor that actually matters is rarely "is oil and gas a good asset class." It is narrower and more technical: does this specific working interest, as structured and documented, actually satisfy the statutory tests your client is relying on.

A working interest held through a liability-limiting LLC or LP does not meet the IRC 469(c)(3)(A) direct-holding requirement, even if the same interest produces identical IDC deductions under 263(c). The deduction classification and the ability to use that deduction against active income are two separate legal questions, and conflating them is the single most common technical error advisors encounter when evaluating this category.

Time-Sensitive Client Scenarios

- Year-end income spike from bonus or K-1 allocation
- 1031 exchange with 45-day identification window closing
- Post-business-sale capital deployment before estimated tax due

The Reputational Risk

- Non-compliant or poorly documented structures
- Structures that defeat their own stated tax purpose
- Conflating deduction classification with active income offset eligibility

Key Findings: Six IRC Provisions That Govern This Structure

The following six statutory provisions collectively define the legal framework for direct working interest participation. Each must be understood independently — and in relation to the others — before advising any client on this structure.

1 IRC Section 263(c) — IDC Expensing Election

Treasury Regulation 1.612-4 allows a working interest holder to elect to expense intangible drilling costs — non-salvageable costs such as labor, fuel, drilling mud, chemicals, site preparation, and hauling — in the year incurred rather than capitalizing them. Tangible costs, including casing, wellhead equipment, and tanks, are capitalized and recovered under MACRS depreciation rules.

2 IRC Section 469(c)(3)(A) — Passive Activity Exception

A working interest is excluded from passive-loss treatment if it is held directly or through an entity that does not limit the taxpayer's liability. There is no material participation or hours-tested requirement for this exception, unlike the real estate professional status test many advisors are more familiar with. The entity structure — not the taxpayer's level of involvement — is what controls eligibility.

3 IRC Section 465 — At-Risk Rules

At-risk rules still apply regardless of how the interest is held. A client's deduction is capped at their actual economic exposure — cash contributed plus recourse debt for which they are personally liable. Nonrecourse debt generally does not count toward at-risk basis in this context, which differs from certain real estate financing structures.

4 IRC Section 57(a)(2) — AMT Preference Item

Excess intangible drilling costs are treated as an alternative minimum tax preference item for integrated producers, with relief generally available where excess IDC does not exceed a defined share of net oil and gas income for independent producers. This is a technical area where your own review of a client's specific facts — rather than a generalized percentage claim — should govern the planning conversation.

5 IRC Sections 611 and 613A — Percentage Depletion

A percentage depletion allowance, generally 15 percent of gross income from production for independent producers, is an ongoing benefit once a well is in production, separate from the upfront IDC election.

6 Revenue Rulings 68-331 and 78-135 — 1031 Like-Kind Treatment

Revenue Ruling 68-331 classifies a working interest in a producing oil and gas lease as real property, like-kind to a fee interest in real estate, for purposes of Section 1031. Revenue Ruling 78-135 is the companion citation: a general partnership interest itself does not qualify for 1031 treatment, which is why the direct-holding question resurfaces here as well — not just in the 469(c)(3) context.

Evidence: Verifiable, Independent, Structural

The throughline across all six IRC provisions above is structural, not promotional. How the interest is held — directly or through a liability-unlimited entity — is the fact pattern that independently determines eligibility under both 469(c)(3)(A) for active income offset and the Revenue Ruling 68-331 analysis for 1031 purposes. An LLC or LP membership interest, or a fund or trust share, fails both tests simultaneously, regardless of the quality of the underlying asset.

> This is evidence you can verify independently: Treasury Regulation 1.612-4 and the statutory text of 26 U.S.C. Section 469(c)(3)(A) are public record. Revenue Ruling 68-331 (1968-1 C.B. 352) and Revenue Ruling 78-135 are available through standard tax research platforms. None of this requires taking Summit's characterization on faith. We encourage you to pull the primary sources directly and confirm the analysis before advising a client.

For documentation purposes, Summit provides:

Direct-Holding Confirmation

Written confirmation of direct-holding structure for each participation — the foundational fact pattern both 469(c)(3)(A) and Rev. Ruling 68-331 depend on

Standardized K-1 Schedule

Built to align with common tax preparation software, reducing manual reclassification work that accompanies less conventional alternative asset K-1s

Tax Opinion Letter Support

Your own review — or your client's separate counsel's review — begins from a documented position rather than a verbal representation

Analysis by Advisory Discipline

The statutory framework applies uniformly, but the practical lens through which each advisor type evaluates it differs. The following analysis addresses each professional audience directly.

CPAs and Tax Professionals

The practical question is whether a client's working interest, once modeled, actually changes their effective tax position within the bounds of 263(c), 469(c)(3)(A), and 465 at-risk limitations. Because the interest is held directly rather than through a fund structure, the K-1 allocation you receive should map cleanly to the categories your preparation software already expects, which reduces the manual reclassification work that often accompanies less conventional alternative asset K-1s.

Registered Investment Advisors

The relevant lens is portfolio construction and diversification within a framework your compliance team can document. A direct working interest position sits outside traded securities markets entirely, which is a genuine diversification characteristic, but it also means illiquidity and valuation methodology are conversations to have explicitly with clients and to document in your own suitability file, independent of any tax benefit discussion.

Qualified Intermediaries

Revenue Ruling 68-331 is the operative citation when a client is evaluating a working interest as replacement property inside a 1031 exchange. It is important to be precise here: Summit does not make the qualification determination for any specific exchange, and a QI should never represent 1031 eligibility as guaranteed. The analysis depends on the client's specific facts, the exchange structure, and how the interest is held — which is exactly why the direct-holding documentation matters at the point of transfer, not after the fact.

Business Brokers and M&A Advisors

The relevant moment is the period immediately following a closing, when a client holds liquid proceeds and faces a capital deployment decision alongside a potential ordinary income or capital gains tax event from the sale itself. This is a context conversation, not a product recommendation: what categories exist, what their statutory basis is, and which ones merit a conversation with the client's own CPA and attorney before any capital moves.

Estate Planning Attorneys

A direct working interest is an asset class with its own valuation, transfer, and reporting characteristics that should be addressed explicitly in trust and estate planning documents — the same way any other illiquid direct-held asset would be. The K-1 allocation and reporting structure matters here because it affects how the interest is tracked across generations or across trust structures, and standardized reporting reduces downstream administrative ambiguity.

Commercial Real Estate Brokers

The connection point is typically a client who has sold a property and is evaluating a 1031 exchange timeline alongside other capital options. Revenue Ruling 68-331's like-kind classification is the relevant technical fact, but as with QIs, this is a conversation to frame as "here is a category your client's tax and exchange advisors should evaluate," not a guarantee of exchange outcome.

Three Structural Paths and the Recommended Next Step

Advisors evaluating this category for a client generally face three structural paths.

1

Path 1: No Action

Continue referring clients only to planning tools already inside your standard toolkit. Appropriate when a client's facts do not support the direct-holding or at-risk requirements described above.

2

Path 2: Internal Review

Engage with Summit as an educational resource — reviewing documentation and statutory citations independently or with your own technical team before any client conversation occurs. **This is the recommended path for most advisors.**

3

Path 3: Joint Technical Discussion

Bring a specific client scenario to a joint technical discussion, where Summit's team walks through documentation alongside your own analysis — without Summit making the final tax or legal determination, which remains your client's responsibility.

> The recommended next step for most advisors in this audience is Path 2: request the underlying documentation — including the direct-holding confirmation language, the standardized K-1 schedule template, and the tax opinion letter framework — and review it against the statutory citations in this briefing before any client is introduced to the structure. Advisors who lead with internal technical review, rather than a client pitch, are the ones who avoid the reputational exposure this audience is specifically trying to manage.

For documentation purposes, request Summit's package including the direct-holding confirmation letter template, standardized K-1 allocation schedule, and tax opinion letter framework.

Request Summit's Documentation Package

Implementation Roadmap and Compliance Safeguards

Six-Step Implementation Roadmap

1. Request Summit's documentation package, including the direct-holding confirmation letter template, standardized K-1 allocation schedule, and tax opinion letter framework.
2. Review the statutory citations in this briefing — IRC 263(c), 469(c)(3)(A), 465, 57(a)(2), 611, 613A, Revenue Ruling 68-331, and Revenue Ruling 78-135 — independently or with your firm's technical review process.
3. Identify whether any current client scenarios — a year-end income spike, a narrowing 1031 window, or a post-sale capital deployment decision — genuinely fit the direct-holding and at-risk fact pattern described above.
4. If a fit exists, schedule a joint technical discussion with Summit's team to walk through documentation for that specific scenario, with your client's own CPA, attorney, or QI included in the review.
5. Confirm K-1 timing and reporting expectations with Summit's CPA support line well ahead of filing season to avoid last-minute reclassification work.
6. Maintain your own file memo documenting the direct-holding confirmation and the statutory basis reviewed, consistent with your firm's standard advisory documentation practices.

Compliance and Regulatory Safeguards

Summit's documentation framework is built specifically to support your professional review process, not to substitute for it. Every participation includes:

- Written confirmation of direct-holding structure — the fact pattern that 469(c)(3)(A) and Rev. Ruling 68-331 both depend on
- Standardized K-1 allocation schedules designed to reduce reclassification work during filing season
- Tax opinion letter support so technical review begins from a documented position rather than a verbal representation
- A direct CPA support line for technical questions during your evaluation process and during filing season itself

None of this replaces your independent judgment or your client's own legal and tax counsel. It is designed to make that independent judgment easier to exercise with complete information.

Questions for Advisor Discussion and Closing Perspective

The advisors who get the most value from this category are the ones who treat it the way they would any other statutory planning tool — by starting with the Code and the Revenue Rulings, confirming the specific fact pattern of the structure in front of them, and only then deciding whether it belongs in a client conversation. Summit built its documentation framework — direct-holding confirmation, standardized K-1 scheduling, and tax opinion letter support — specifically so that review process has a clear starting point.

CPAs and Tax Professionals

Does this specific client's working interest documentation confirm direct holding or holding through a liability-unlimited entity, and has the at-risk basis under IRC 465 been modeled against the client's actual cash and recourse debt exposure?

Registered Investment Advisors

How does a direct working interest position fit within your firm's existing suitability and illiquidity documentation requirements, independent of any tax characterization?

Qualified Intermediaries

Has Revenue Ruling 68-331's like-kind analysis been reviewed against this specific exchange's facts, and has the client's own exchange counsel confirmed the qualification determination rather than relying on a general category description?

Business Brokers and M&A Advisors

Has the client's post-sale tax exposure — ordinary income versus capital gains components — been separated clearly enough to evaluate which planning tools, including this one, are actually relevant to their specific liability?

Estate Planning Attorneys

How will this asset class be described, valued, and transferred within the client's existing trust or estate documents, and does the standardized K-1 reporting structure simplify or complicate that documentation?

Commercial Real Estate Brokers

Is the client's 1031 timeline tight enough that a replacement property conversation needs to happen now, and has that client already engaged a QI and tax advisor who can evaluate Revenue Ruling 68-331 against the specific exchange facts?

If a current client scenario raises one of the questions above, the next reasonable step is a technical conversation with Summit's team — with your own CPA network, attorney, or QI involved from the outset, not after the fact.

SOURCES: 26 U.S.C. §469(C)(3)(A) · TREAS. REG. 1.612-4 · IRC §§263(C), 465, 57(A)(2), 611, 613A · REV. RUL. 68-331 · REV. RUL. 78-135 · EIA ANNUAL ENERGY OUTLOOK 2026 · ONE BIG BEAUTIFUL BILL ACT (JULY 2025)

Begin Your Technical Review with Summit

Request Documentation Package