

Delaware Statutory Trusts vs. Direct Producing Working Interests

A Comparative Guide to Structural Transparency, Depletion-Based Tax Treatment, and Qualification Mechanics for Owners Exiting Apartment Portfolios

1031 EXCHANGE | MULTIFAMILY SELLERS | TAX STRATEGY

The Question Every Multifamily Seller Faces

If you are selling an apartment complex, workforce housing property, or student housing asset and want out of active property management, the replacement-property conversation almost always starts in the same place: the Delaware Statutory Trust. DSTs dominate multifamily 1031 marketing because they solve one problem well — they remove the landlord from day-to-day operations. But removing operational burden and removing operational say are not the same outcome, and the fee and yield mechanics behind that removal are frequently underexplained.

This guide compares two qualified replacement-property categories for a multifamily owner completing a Section 1031 exchange: a Delaware Statutory Trust (DST) interest in a multifamily property, and a direct producing working interest in an oil and gas property structured as an entrepreneurial joint venture. Both can qualify as like-kind replacement property. They differ substantially in title structure, governance, cost load, ongoing tax mechanics, and what "exiting management" actually means in practice.

The comparison is presented objectively so that a seller and their CPA or 1031 qualified intermediary (QI) can evaluate both categories against the same criteria.

Two Options, One Goal

Option A: Delaware Statutory Trust (DST) — A separate legal trust holding title to real property. The exchanger owns a beneficial interest in the trust, not a deed to any specific unit or building.

Option B: Direct Producing Working Interest — An operating ownership position in an oil and gas lease, carrying both the right to a share of production revenue and the obligation to pay a proportionate share of development and operating costs.

Both can qualify as like-kind replacement property under Section 1031. The differences are in the details.

Eight Criteria for Evaluation

A multifamily seller evaluating either path should weigh the same set of factors regardless of asset class:

1	**Statutory Basis for 1031 Qualification** What IRS authority supports treating the replacement property as like-kind, and how settled is that authority.
2	**Title and Ownership Structure** Does the exchanger hold record title and a direct economic interest, or a beneficial interest in a trust that holds title.
3	**Participation and Governance** Who makes operating, financing, and disposition decisions after closing.
4	**Timeline Fit** How the structure interacts with the 45-day identification window and 180-day closing deadline.
5	**Ongoing Tax Treatment** How income is sheltered year over year, not just at the point of closing.
6	**Cost Structure** What is paid upfront, annually, and at disposition — and who receives it.
7	**Liquidity and Holding Period** How long capital is committed and what exit options exist before the structure's natural end.
8	**Complexity and Reporting** What the exchanger receives each year for tax preparation, and how transparent the underlying asset-level economics are.

Option A: The Delaware Statutory Trust

The DST's 1031 eligibility rests on **Revenue Ruling 2004-86**, which held that a beneficial interest in a properly structured Delaware statutory trust is treated as a direct interest in the underlying real estate for Section 1031 purposes — not an interest in a business entity. That classification depends on the trustee being restricted from a defined set of active management powers.

The Seven Core Restrictions

No new capital contributions once the offering closes. No refinancing or renegotiation of existing debt except in tenant-default distress. No new leases or material lease renegotiation outside existing terms. No reinvestment of sale or refinancing proceeds — both must be distributed. Cash reserves held only in short-term instruments. No capital improvements beyond normal maintenance or legally required work. No active, discretionary trustee management of the property.

What This Means in Practice

These restrictions are the direct source of the "zero operational control" experience many multifamily sellers describe. The trust sponsor — not the exchanger — selected the asset, negotiated the debt, and set the business plan before the offering was ever marketed. After closing, neither the sponsor nor the investor can adjust course even if market conditions change, because doing so would convert the trust into a business entity and disqualify every participant's exchange.

Cost Structure

DST cost layers are multi-tiered. A 2026 analysis of 90 Delaware Statutory Trust Form D filings found a **median selling commission of 7.00 percent** of offering proceeds, with a range from near zero to 10.27 percent depending on sponsor and distribution channel, plus separate acquisition, due diligence, and wholesaling fees. Earlier industry estimates placed all-in upfront load at roughly 5 to 8 percent, with total fee drag across the holding period — including annual asset and property management fees of 1.5 to 3.0 percent and a disposition fee plus sponsor promote above a preferred return hurdle — running toward the higher end of a broad range once every layer is counted. Minimum investments for 2025 and 2026 DST offerings commonly cluster around a **$100,000 median**.

Current Cash Yield & Liquidity

Multifamily-specific DST year-one distribution rates have historically run lower than other DST property types — roughly **4.25 to 5.25 percent** — compared with 6 to 9 percent for industrial and 5 to 6.5 percent for net lease offerings in the same 2026 sponsor review. Distribution rates are also structurally flat: because the trustee cannot renegotiate leases or refinance debt, a DST's income stream tends to stay level rather than grow with the portfolio.

DSTs are illiquid by design. Typical holding periods run **5 to 10 years**, set by the sponsor's original business plan, and a secondary market for beneficial interests is thin; when a willing buyer can be found at all, resale has been reported to require a discount of **20 to 50 percent** to book value.

Option B: The Direct Producing Working Interest

A direct producing working interest rests on a different, older line of IRS authority. **Revenue Ruling 68-331** holds that an operating interest in oil and gas in place is real property for purposes of a like-kind exchange, and the companion **Revenue Ruling 68-226** confirms that a lessee's working interest in oil and gas in place is also real property. Unlike the DST's trust-wrapped structure, there is no single "packaged offering" revenue ruling for working interests; qualification instead rests on this case law and ruling authority together with Treasury Regulation 1.1031(a)-3's state-law real property test.

Title and Structure

Where a DST exchanger owns a beneficial interest in a trust, a working interest owner under Summit Ventures' entrepreneurial joint venture model holds a **direct title position in the underlying lease**, reported on the business participant's own Schedule K-1 and allocated an undivided interest in the asset itself. To preserve that direct, real-property characterization for exchange purposes, the position must be held directly or through a structure that does not limit liability — such as a general partnership electing out of Subchapter K under Section 761(a) — rather than through a liability-shielding fund or LLC that would recharacterize the interest as a security.

Governance

Operating decisions — including workover timing, recompletion, and disposition — are documented under a joint operating agreement (JOA) and authorization-for-expenditure (AFE) process, with the business participant **retaining governance rights over major decisions** rather than ceding them permanently to a sponsor-controlled trustee. This is the structural inverse of the DST's trustee restrictions: participation is active and documented, not prohibited by the qualification mechanics itself.

Cost Structure, Liquidity & Complexity

Because the position is a direct title interest rather than a packaged security with multiple intermediary layers, cost structure is communicated through the **AFE and lease operating statement** rather than a prospectus fee table, and there is no sponsor promote carried above a preferred return hurdle.

Production income is distributed as it is generated under the JOA accounting rather than following a multi-year sponsor-set business plan, though production volumes — and therefore distributions — naturally decline over a well's productive life, a mechanical and operational reality distinct from a DST's governance-driven income flatness.

Tax reporting is delivered via **Schedule K-1 with depletion schedule**, providing direct visibility into asset-level economics. The business participant must engage with operating decisions and reporting rather than delegating all of it to a third-party trustee.

The Core Tax Mechanics Difference: Percentage Depletion

Under **IRC Section 613A**, independent producers and royalty owners may compute percentage depletion at a statutory rate of **15 percent of gross income** from a producing property, rather than cost depletion based on basis. Three mechanical features make this materially different from multifamily depreciation:

1 Uncapped by Basis

Percentage depletion is calculated on gross production income, not net income, and is **not limited by the owner's adjusted basis in the property**. Under Section 613A(c), it can continue to be claimed even after basis has been reduced to zero, for as long as the property produces income. Depreciation on a DST's underlying real estate, by contrast, is a basis-recovery mechanism that is exhausted once the depreciable basis is used up.

2 AMT Treatment

Percentage depletion for independent producers and royalty owners is **specifically excepted from alternative minimum tax preference treatment** under Section 57(a)(1) — a distinct provision from the separate excess-intangible-drilling-cost AMT preference under Section 57(a)(2) that applies in a working interest's drilling year.

3 Two Annual Caps to Model

Percentage depletion is limited to **100 percent of the taxable income from the property itself** (modified from the general 50 percent rule specifically for oil and gas properties), and in aggregate across all properties, percentage depletion is limited to **65 percent of the taxpayer's overall taxable income** under Section 613A(d)(1), computed before the depletion deduction, net operating loss carrybacks, and certain capital loss carrybacks. Eligibility itself is restricted to independent producers.

A working interest position may also carry a current-year intangible drilling cost (IDC) election under Section 263(c) in the year capital is deployed into active drilling — a separate, one-time mechanism from the ongoing depletion allowance. Actual tax treatment depends on the specific drilling program, individual circumstances, and should always be confirmed with a qualified tax professional before capital is contributed.

1031 Qualification Mechanics Compared

A seller with a live 45-day identification clock needs to know how each structure actually gets classified as "real property" for exchange purposes.

DST Path: Revenue Ruling 2004-86

The DST path relies on a single, purpose-built ruling: Revenue Ruling 2004-86 treats the trust's passive, restricted structure as equivalent to direct real estate ownership, provided the trustee stays inside the defined restrictions. This gives sponsors a repeatable, IRS-recognized packaging format — which is part of why DST fundraising has scaled into the billions annually and why DSTs are the most heavily marketed multifamily replacement vehicle.

Working Interest Path: Older, More Fundamental Authority

The working interest path relies on an older and more fundamental classification: Revenue Rulings 68-331 and 68-226 establish that oil and gas in place — and a lessee's working interest in it — are themselves real property, independent of any trust-wrapping ruling. Treasury Regulation 1.1031(a)-3 applies the state-law test for what counts as real property, and Section 1031(a)(2) together with a Section 761(a) election allows a working interest held through a partnership that elects out of Subchapter K to be treated as a direct undivided interest in the underlying asset rather than a partnership interest.

The practical requirement that follows: the position must be held directly, or through an entity that does not limit liability, to retain both its real-property classification for exchange purposes and its active-income tax treatment under Section 469(c)(3).

DST Path

Revenue Ruling 2004-86; trust-wrapped, passive, sponsor-controlled

Working Interest Path

Rulings 68-331 & 68-226; direct title, active governance, JOA-documented

Side-by-Side Comparison

Category	Delaware Statutory Trust	Direct Producing Working Interest
Statutory Basis	Revenue Ruling 2004-86 (trust-wrapped packaging)	Revenue Rulings 68-331 and 68-226; Treas. Reg. 1.1031(a)-3
Title Structure	Beneficial interest in a trust that holds title	Direct, undivided title interest in the lease
Participation Level	None; trustee discretion is restricted by design	Active; governance rights under a JOA
Governance and Control	Sponsor-set business plan fixed at closing	Business participant retains decision rights on major actions
Timeline Fit	Fast close, 3–5 days; sponsor already owns the asset	Identification and closing coordinated with QI before the 180-day deadline
Ongoing Tax Mechanics	Depreciation on individual carried-over basis, exhausted over time	Percentage depletion, 15% of gross income, uncapped by basis
Current Cash Yield (Multifamily)	Historically 4.25–5.25% in year one	Determined by well-level production economics, reviewed property by property
Cost Structure	Multi-layer: selling commission (median 7.00%), acquisition fees, annual asset/property management, disposition fee, sponsor promote	AFE-documented drilling and operating costs; no sponsor promote layer
Liquidity and Hold Period	Illiquid; typical 5–10 year hold; thin secondary market at reported 20–50% discount	Production-life based; no secondary trading market assumed
Minimum Participation	Commonly clustered near $100,000	Set per program and lease position
Eligibility	Generally accredited investors under Rule 506(c)	Direct business participants under JOA/AFE documentation
Tax Reporting	Grantor trust letter	Schedule K-1 with depletion schedule
Complexity	Moderate; sponsor pre-packages the asset and decisions	Higher; requires direct engagement with operating decisions

Advantages, Limitations & Best-Fit Scenarios

Delaware Statutory Trust

Advantages include a single, well-tested qualification ruling, fast closing speed since the sponsor already owns the property, non-recourse debt held at the trust level that does not attach to the investor's other assets, and no day-to-day management responsibility of any kind.

Limitations include the same restrictions that create that convenience: no ability to influence refinancing, leasing, or disposition timing, a cost structure with several fee layers that compound over the holding period, a historically modest current yield in the multifamily sector specifically, and limited liquidity before the sponsor's planned exit.

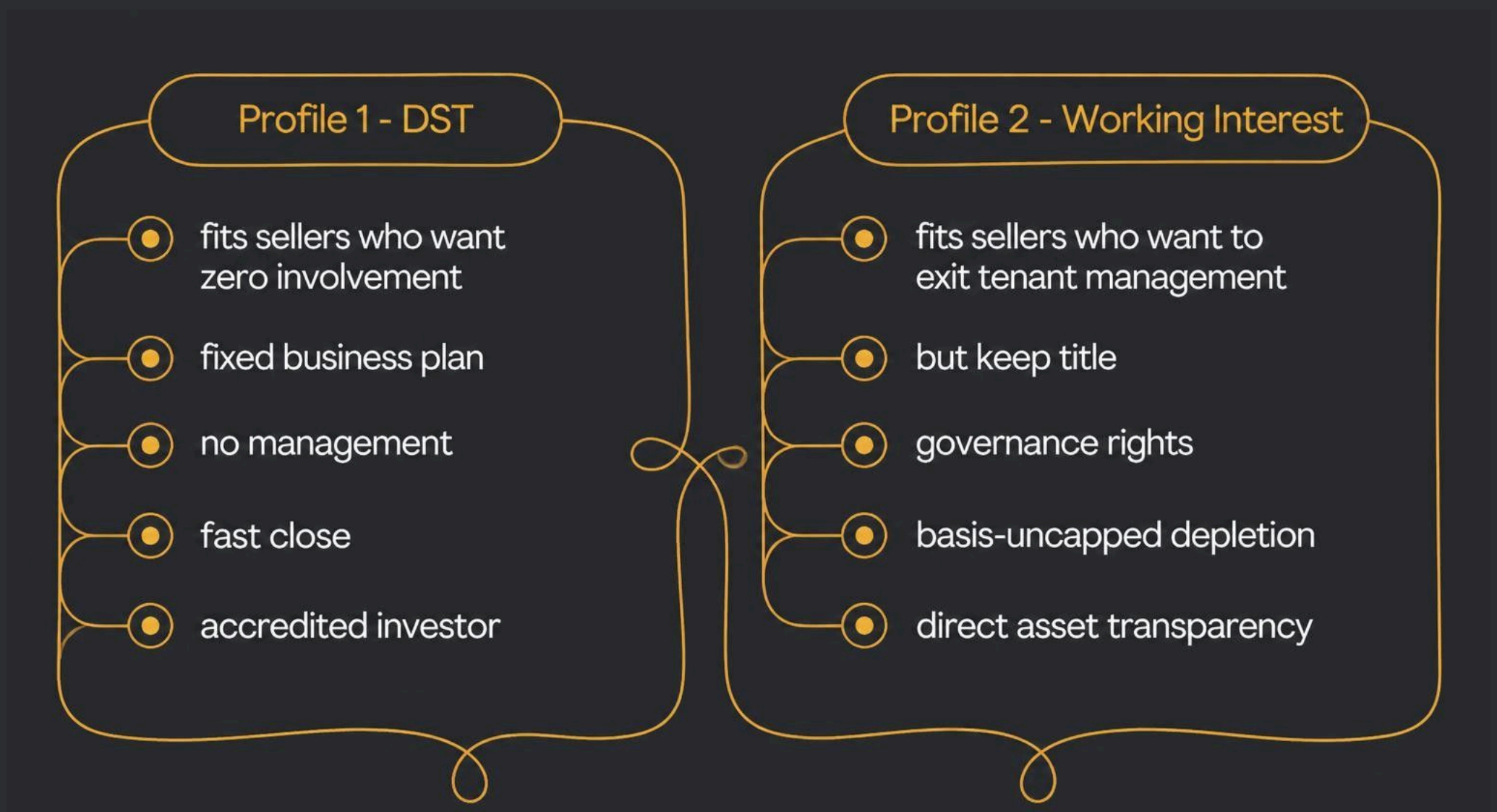
Best fit: A multifamily seller whose primary goal is eliminating every decision point, who is comfortable with a fixed, sponsor-set business plan, and who does not need the position to generate growing income or offer any say in refinancing or disposition timing.

Direct Producing Working Interest

Advantages include direct title ownership rather than a beneficial trust interest, governance rights over major operating decisions through the JOA, an ongoing percentage depletion allowance that is not capped by basis and continues for the productive life of the property, and a cost structure documented at the asset level rather than layered through sponsor fee tiers.

Limitations include a qualification path that depends on correct direct-holding structure rather than a single packaged ruling, production income that naturally declines over a well's life rather than staying flat, and a requirement for the business participant to engage with operating decisions and reporting rather than delegating all of it to a third-party trustee.

Best fit: A multifamily seller who wants to stop managing tenants and physical assets specifically — "toilets, tenants, and trash" — but still wants record title, governance rights on major decisions, and an ongoing tax mechanism (percentage depletion) that is not exhausted the way depreciation is. Also fits a seller whose CPA has identified that the depletion allowance's lack of a basis ceiling is more valuable to their specific tax position over a multi-year holding period.



Decision Guidance & Next Steps

A multifamily owner weighing a 1031 exchange out of an apartment portfolio is really choosing between two different definitions of "no longer a landlord." A Delaware Statutory Trust removes every decision — along with every layer of sponsor fee and the ability to influence outcomes. A direct producing working interest removes tenant and property management specifically while preserving title, governance rights, and a depletion-based tax mechanic built around the depletion of a resource over its productive life, rather than the recovery of a fixed basis. Neither path is universally superior. The right fit depends on how much structural transparency and continuing participation a seller wants after the exchange closes.

Map Your Actual Priority

If the priority is truly zero involvement at any cost, the DST's restrictions are a feature, not a flaw. If the priority is reducing tenant and property management specifically while retaining title and a voice in major decisions, the direct working interest structure is architecturally closer to that goal.

Model the Fee Layers Against the Yield

A sponsor promote, disposition fee, and annual management fee compound against a multifamily DST's historically modest 4.25 to 5.25 percent year-one distribution rate differently than a single-layer AFE-documented cost structure.

Ask Your CPA to Run Both Tax Mechanisms Forward

Depreciation recapture under Section 1250 and the depletion recapture rules under Section 1254 produce different outcomes at a future sale, and percentage depletion's basis-uncapped design behaves differently over a 10, 15, or 20-year horizon than a depreciation schedule tied to original basis.

Confirm the Direct-Holding Requirement With Counsel

The real-property and active-income treatment described in this guide for working interests depends on direct title or a properly structured general partnership election. Routing capital through a liability-limiting fund or LLC can forfeit both.

Questions for Your Advisory Team

- Which revenue ruling governs qualification for the specific replacement property we are reviewing, and has counsel confirmed the structure matches it exactly?
- What is the all-in fee load across the full holding period, not just the upfront selling commission?
- What happens to my distribution rate and my say in the asset if market conditions change after closing?
- How does percentage depletion's lack of a basis ceiling compare, in my specific tax bracket and holding period, to a depreciation schedule on the replacement property's carried-over basis?
- What recapture exposure exists at a future sale under Section 1250 versus Section 1254, and how does that change the comparison?
- If I am not ready to decide, what is the realistic secondary-market outcome if I need liquidity before the structure's planned end?

This conversation is best had directly with a CPA, 1031 qualified intermediary, and legal counsel before the 45-day identification window runs.

Speak With Summit Ventures