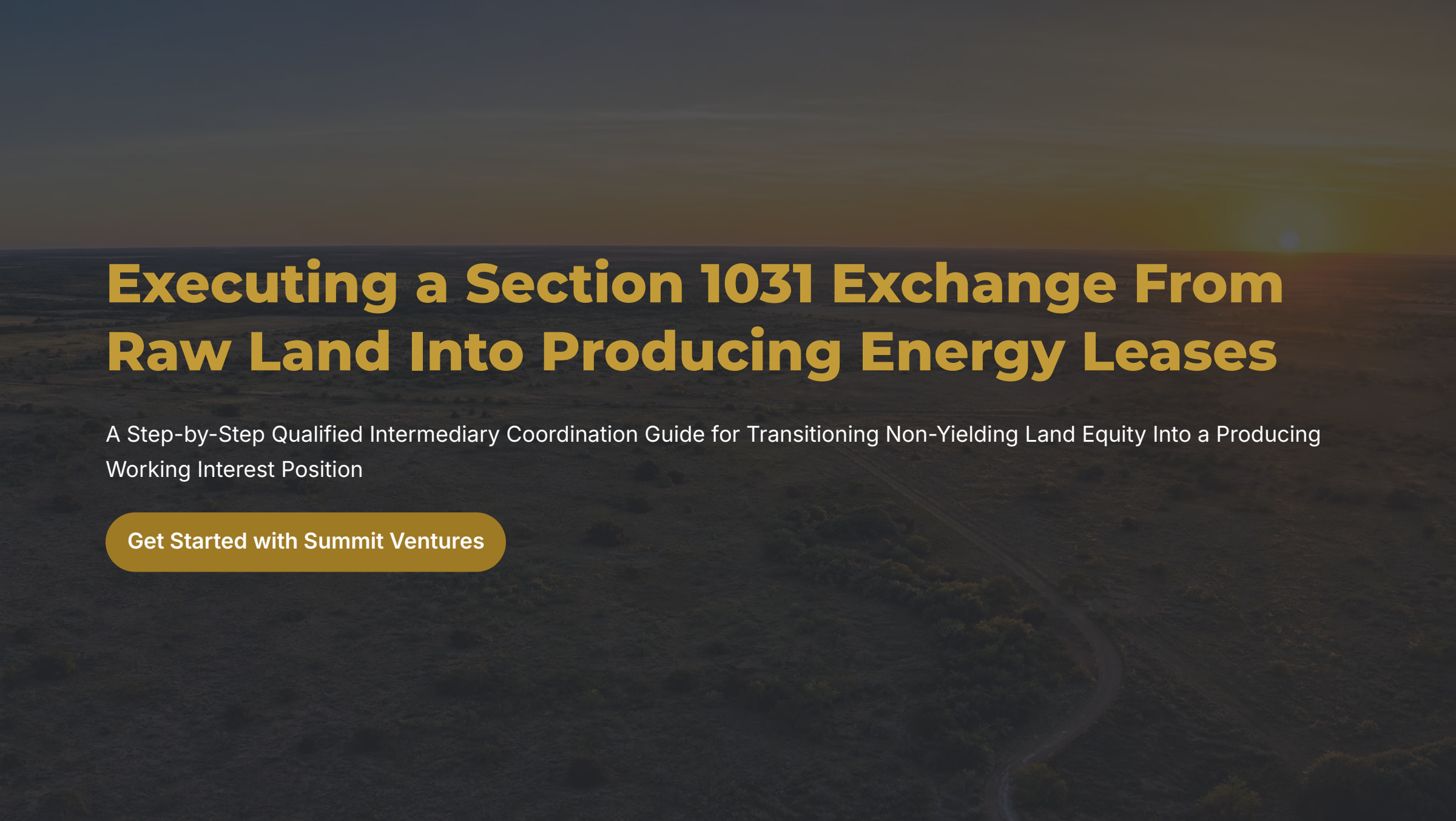


Executing a Section 1031 Exchange From Raw Land Into Producing Energy Leases

A Step-by-Step Qualified Intermediary Coordination Guide for Transitioning Non-Yielding Land Equity Into a Producing Working Interest Position

Get Started with Summit Ventures

Purpose & Scope

Why This Guide Exists

This guide explains the complete, sequential process a land or development tract owner follows, working alongside a Qualified Intermediary (QI), to redeploy sale proceeds from raw acreage, ranch land, or a development parcel into a working interest in a producing domestic oil and gas lease under Section 1031 of the Internal Revenue Code.

Raw land and undeveloped tracts are a common source of large, long-held, low-basis gains, and they share a structural limitation that commercial buildings and multifamily assets do not have: there is no tenant, no lease, and no rent, so there is no current income to offset the carrying cost of the parcel while it appreciates.

A producing working interest replaces that non-yielding equity with an asset that is still classified as real property for federal tax purposes, while removing the land's ongoing ad valorem tax drag and avoiding the tenant and maintenance oversight that comes with a traditional commercial replacement property.

What This Guide Covers

- Raw and vacant land, ranch acreage, agricultural parcels, and undeveloped development tracts held for investment or for productive use in a trade or business
- Exchangers planning a direct, delayed (forward) exchange into one or more working interests — not a reverse or improvement exchange, which carry separate mechanics
- Both a full like-kind replacement path and a parallel tax boot mitigation path for situations where the identification or closing window cannot be met, or where some boot is unavoidable

⚠ This guide does not address state-specific transfer tax treatment, entity-level restructuring, or international property. Readers should confirm every step below with their own CPA, tax counsel, and the engaged QI before signing closing documents.

The Core Advantage

A producing working interest gives land sellers a real property replacement category that converts dormant land equity into an income-producing position — without introducing the landlord responsibilities that a conventional commercial property would require.

The Two Statutory Clocks

45 Days

Written identification of candidate replacement working interests delivered to QI

180 Days

Close on one or more of the identified interests

Both clocks begin on the same day — the day the land sale closes — and do not pause, extend, or reset for financing delays, due diligence findings, or any other practical obstacle short of a federally declared disaster.

Prerequisites Before You Begin

Before beginning, the exchanger should confirm the following with a tax advisor:

1	2	3
Investment or Business-Use Intent	**No Existing Contract Has Closed**	**Know Your Numbers**
Dealer property — meaning land held primarily for resale rather than investment — does not qualify for 1031 treatment. Raw land held for investment or business use, such as leased land, generally may qualify for a 1031 exchange. Land held primarily for resale, such as subdivided lots actively marketed to buyers, is typically treated as dealer property and does not qualify. This distinction is especially relevant for development tracts: property held primarily for resale, as inventory in a business, is specifically excluded from 1031 treatment. The classic example is a developer who buys a large parcel, subdivides it into lots, and sells them off — the lots are inventory rather than investment property and the gain is ordinary dealer income that a 1031 cannot defer. A development tract that has been actively subdivided, entitled, and marketed to buyers should be reviewed carefully with counsel before assuming exchange eligibility.	No existing contract to sell the land has closed yet. Once closing proceeds are received directly, the exchange opportunity is gone.	A general understanding of the current adjusted basis, outstanding debt to be paid off at closing, and expected gain, so the QI and CPA can size the replacement requirement correctly.

Required Inputs & Tools

The following documents and resources must be assembled before and during the exchange process:

Exchange Agreement with QI

A signed exchange agreement with an independent, non-disqualified Qualified Intermediary, executed before the land sale closes.

Land Sale Documents

The land sale contract and closing/settlement statement. Written legal description sufficient to identify replacement property candidates — for a working interest, this means lease name, well name, API number, and county/state, not a street address.

Title Opinion

A title opinion on each candidate working interest, confirming clean and defensible title to the real property interest being acquired.

Reserve Engineering Summary

A reserve engineering summary on each candidate producing lease, documenting current production status and reservoir characteristics to support both valuation parity and ordinary diligence.

CPA / Tax Counsel

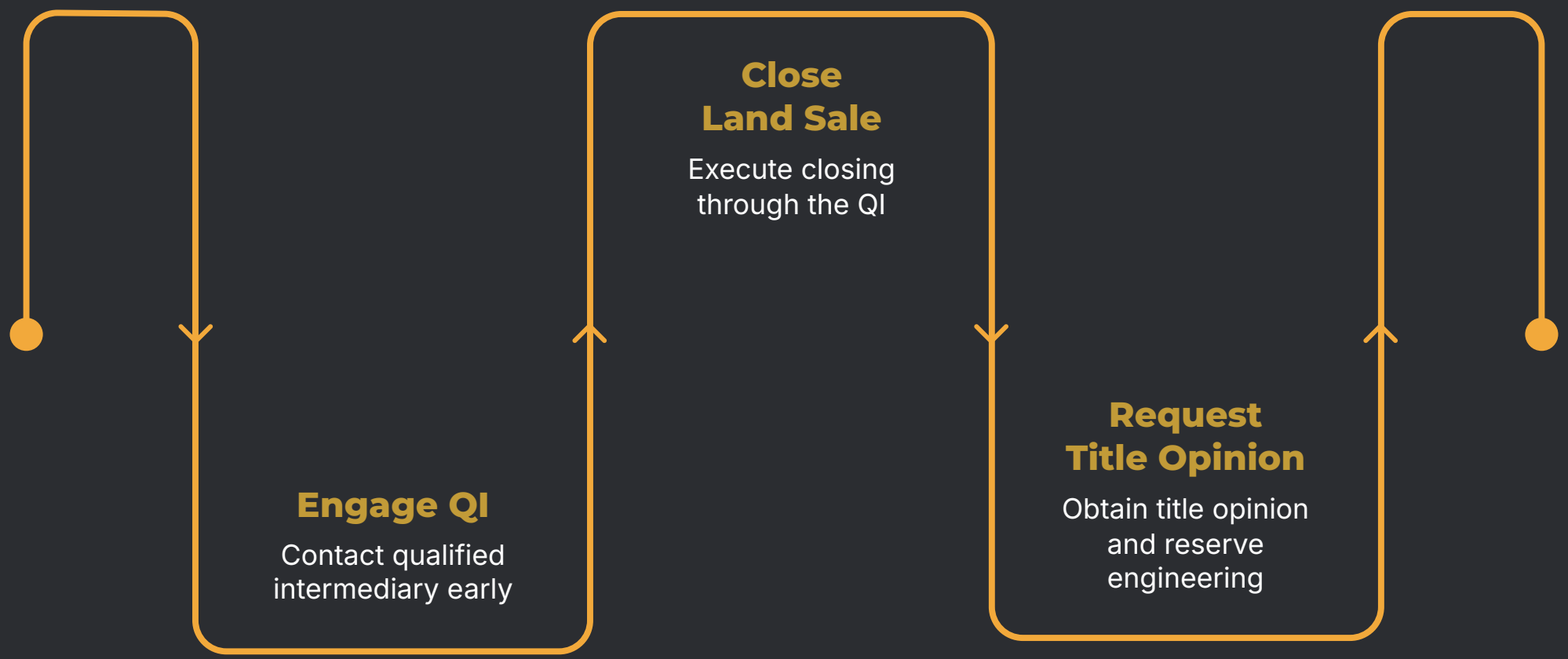
CPA or tax counsel coordination throughout, particularly for basis allocation and Form 8824 preparation.

Summit Ventures QI Package

Summit Ventures' QI coordination package, which packages the title opinion, reserve engineering summary, and lease-level documentation the QI and exchanger's advisors need to confirm the replacement interest in a format consistent with the identification and closing requirements.

Request the Summit Ventures QI Package

Step-by-Step Process: Steps 1–3



1 Confirm Eligibility and Engage the QI Before the Land Sale Closes

The single most common and most avoidable failure point in any 1031 exchange is engaging the QI too late. For a valid delayed or forward exchange, a QI must be in place prior to the sale of relinquished property to prevent the actual or constructive receipt of funds by the exchanger — otherwise triggering a taxable event. The QI needs to be engaged before the relinquished property closes, with the exchange agreement in place at or before that closing for the structure to work, which means QI selection happens early, often in the same conversation where the sale is being finalized.

The QI's engagement letter, assignment of the land sale contract, and notice of assignment to the buyer should all be signed before the closing table, not after.

2 Close the Land Sale Through the QI and Confirm No Constructive Receipt of Funds

The buyer's proceeds are wired directly to the QI's qualified escrow or qualified trust account, never to the exchanger. The exchanger's deed to the buyer still passes directly from the exchanger; the QI does not take title to the land itself — it simply holds the cash and administers the paperwork.

3 Request a Title Opinion and Reserve Engineering Summary on Each Candidate Working Interest

Before the 45-day clock starts running down, the exchanger should begin reviewing candidate producing leases. A title opinion confirms the lease, well, and working interest percentage being conveyed are free of defects that would undermine the real property classification needed for the exchange. A reserve engineering summary documents the lease's current producing status, which supports both the productive use in a trade or business or for investment test and an informed valuation comparison against the relinquished land's sale price.

Step-by-Step Process: Steps 4–6

1 Deliver Written Identification of Replacement Working Interests Within 45 Calendar Days

The IRS regulations require the identification of replacement properties be in writing, be signed by the exchanger, and be delivered to a party to the contract who is not disqualified, and properties should be identified by street address and/or legal description. For a working interest, the equivalent of a legal description is the lease name, well name, API number, and county/state, since there is no street address.

Exchangers may identify up to three candidate interests of any value, or more than three interests if their combined value does not exceed 200 percent of the relinquished land's value. Disqualified parties who cannot receive this identification include agents of the taxpayer at the time of the transaction, related parties, and anyone who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent within the two-year period ending on the date of transfer.

2 Complete Due Diligence, Confirm Value and Debt Parity, and Finalize Documentation Within the 180-Day Window

To defer the full gain, the replacement working interest (or interests) generally must be equal to or greater in value than the relinquished land, with all net equity reinvested and any debt paid off at the land closing either replaced or offset with additional cash contributed into the exchange. A direct working interest, held individually or through an entity that does not limit liability, is the structure that preserves like-kind treatment.

Mineral rights are an interest in real property, and the IRS has recognized exchanges of mineral rights for city lots and ranch land as like-kind, while working interests held directly as a co-owner — not as a partner — are the structure that qualifies. Partnership interests are listed among intangibles that are never real property unless the partnership has a valid Section 761(a) election in effect, and severed production ceases to be real property once it is extracted or removed from the land.

This is why Summit Ventures' structure is built around direct working interest ownership and governance rights rather than a pooled partnership or fund unit: a multi-member LLC or limited partnership interest that shields liability will not carry the same like-kind treatment as a direct working interest position.

3 Close on the Working Interest and Record the Assignment

The QI releases the held exchange funds directly to the seller of the working interest at closing, and the assignment of the working interest is recorded in the exchanger's name (or qualifying holding structure). The exchanger never has access to the funds at any point between Step 2 and this closing.

Step 7 (Parallel Path): If a suitable working interest cannot be identified and closed within the statutory windows, or if a portion of the land sale proceeds will be received as boot, a direct capital contribution into a working interest outside of the 1031 structure can still support an available election under IRC Section 263(c) to treat the intangible drilling cost portion as currently deductible rather than capitalized. This is a separate statutory benefit from the exchange itself — not a substitute for completing the exchange — and should always be confirmed with a CPA rather than assumed at a flat rate.

Key Decision Points

Before and during the exchange, exchangers face several critical decisions that affect both eligibility and outcome:

Direct Working Interest vs. Pooled or Fund Structure

Only a directly held working interest (or one held through an entity without a liability-limiting election) supports like-kind treatment. A fund unit or limited partnership interest generally does not.

Three-Property Rule vs. the 200 Percent Rule

Exchangers considering more than three candidate leases should confirm combined identified value against the 200 percent threshold with the QI before the 45-day deadline.

Full Exchange vs. Partial Exchange with Planned Boot

If full reinvestment is not practical, the exchanger should decide in advance whether to accept and pay tax on a known boot amount or redirect that portion into a 263(c) capital contribution.

Development Tract Dealer-Status Review

Tracts that have been subdivided, entitled, or actively marketed should be reviewed with counsel before the land is listed, since a dealer-property finding removes 1031 eligibility entirely regardless of the replacement property chosen.

Single Large Working Interest vs. Multiple Smaller Positions

Diversifying identified replacement interests across more than one producing lease can reduce reliance on any single well while still satisfying identification rules.

Roles & Responsibilities

01 Exchanger

- confirms holding intent
- engages QI before closing
- signs and delivers identification within 45 days
- directs final closing instructions

02 Qualified Intermediary

- holds sale proceeds
- prepares exchange agreement and assignment documents
- receives written identification
- disburses funds at replacement closing

03 CPA or Tax Counsel

- confirms investment-versus-dealer classification
- basis and gain calculations
- debt and boot analysis
- prepares Form 8824

04 Closing Attorney or Title Company

- handles land sale closing and working interest closing and assignment recording

Common Problems to Avoid

- Engaging the QI after the land sale has already closed, which ends the exchange opportunity entirely once proceeds are received
- Treating a subdivided or actively marketed development tract as automatically exchange-eligible without first confirming investment — not dealer — intent
- Identifying a candidate lease informally (by phone or email summary) rather than through a written, signed, properly delivered identification notice
- Attempting to acquire the replacement interest through a fund unit or limited partnership interest, which does not preserve like-kind treatment the way a direct working interest does
- Underestimating debt payoff at the land closing and failing to offset the resulting shortfall with additional cash, creating unplanned boot
- Waiting until late in the 45-day window to request a title opinion or reserve engineering summary, leaving no time to review findings before the identification deadline



Quality Checks & Pre-Completion Verification

Before relying on the exchange as complete, confirm each of the following:

- [x] ~~The QI engagement letter and assignment of the land sale contract were both signed and delivered before the relinquished property closing, not after.~~
- [x] ~~The written identification notice was signed by the exchanger and delivered to the QI or another non-disqualified party before day 45.~~
- [x] ~~Each identified working interest is described unambiguously, with lease name, well name, API number, and county/state.~~
- [x] ~~The replacement interest is held directly, or through an entity structure confirmed by counsel to preserve like-kind treatment, rather than as a fund or partnership unit.~~
- [x] ~~Combined value and debt replacement (or offsetting cash contribution) were reviewed with the CPA to confirm the expected boot exposure, if any.~~
- [x] ~~The title opinion and reserve engineering summary on the acquired interest have been reviewed and retained alongside the exchange file.~~
- [x] ~~Form 8824 is prepared and filed for the tax year in which the land was transferred.~~

Pre-Exchange Questions to Answer with Your Advisors

Has the relinquished land's holding history, any subdivision or marketing activity, and overall intent been reviewed with a tax advisor to confirm it is not dealer property?

Is the QI engagement letter fully executed, and has it been confirmed in writing that it was in place before the land sale closing?

Does the written identification notice name each candidate lease unambiguously, and has delivery to a non-disqualified party been confirmed in writing?

Has the CPA modeled the expected boot exposure based on debt payoff and reinvestment amount, and is there a plan to offset any shortfall with additional cash?

Has the title opinion and reserve engineering summary for each candidate working interest been received and reviewed before the identification deadline, not after?

If the clock cannot be met, has the 263(c) boot mitigation path been discussed with the CPA as a parallel option rather than a fallback decided under time pressure?

Expected Outcome & Next Steps

> When each step above is completed within the statutory windows, the exchanger converts a non-yielding, appreciated parcel of land — carrying an ongoing property tax obligation and no current income — into a working interest position in a producing lease that generates monthly distributions without the tenant management, leasing, and maintenance responsibilities that come with a conventional commercial replacement property.

The replacement interest remains classified as real property for federal tax purposes, consistent with the direct JV structure and governance rights that define working interest ownership. The exchanger retains the documentation — title opinion, reserve engineering summary, signed identification notice, and Form 8824 — needed to support the position on examination.

Land and development tract owners carrying appreciated, non-yielding acreage face a narrower set of practical replacement options than commercial real estate sellers, simply because raw land produces no rent to replace. A producing working interest, acquired through a properly sequenced exchange and supported by a title opinion and reserve engineering summary, gives this group of exchangers a real property replacement category that converts dormant land equity into an income-producing position without introducing the landlord responsibilities that a conventional commercial property would require.

The statutory mechanics above are unforgiving on timing, so the earliest possible step — engaging the QI before the land sale closes — remains the most consequential decision in the entire process.

45

Day Identification Deadline

Written ID of replacement interests must be delivered to QI

180

Day Closing Deadline

Must close on identified replacement working interest(s)

3

Property Rule

Maximum candidate interests of any value under the three-property rule

200%

Value Threshold

Combined identified value limit when identifying more than three properties

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Ready to Begin Your 1031 Exchange Into a Producing Working Interest?

Summit Ventures provides the title opinion, reserve engineering summary, and QI coordination package your advisors need — structured as a direct working interest position consistent with like-kind treatment requirements.

Connect with Summit Ventures Today | Learn More About Working Interests