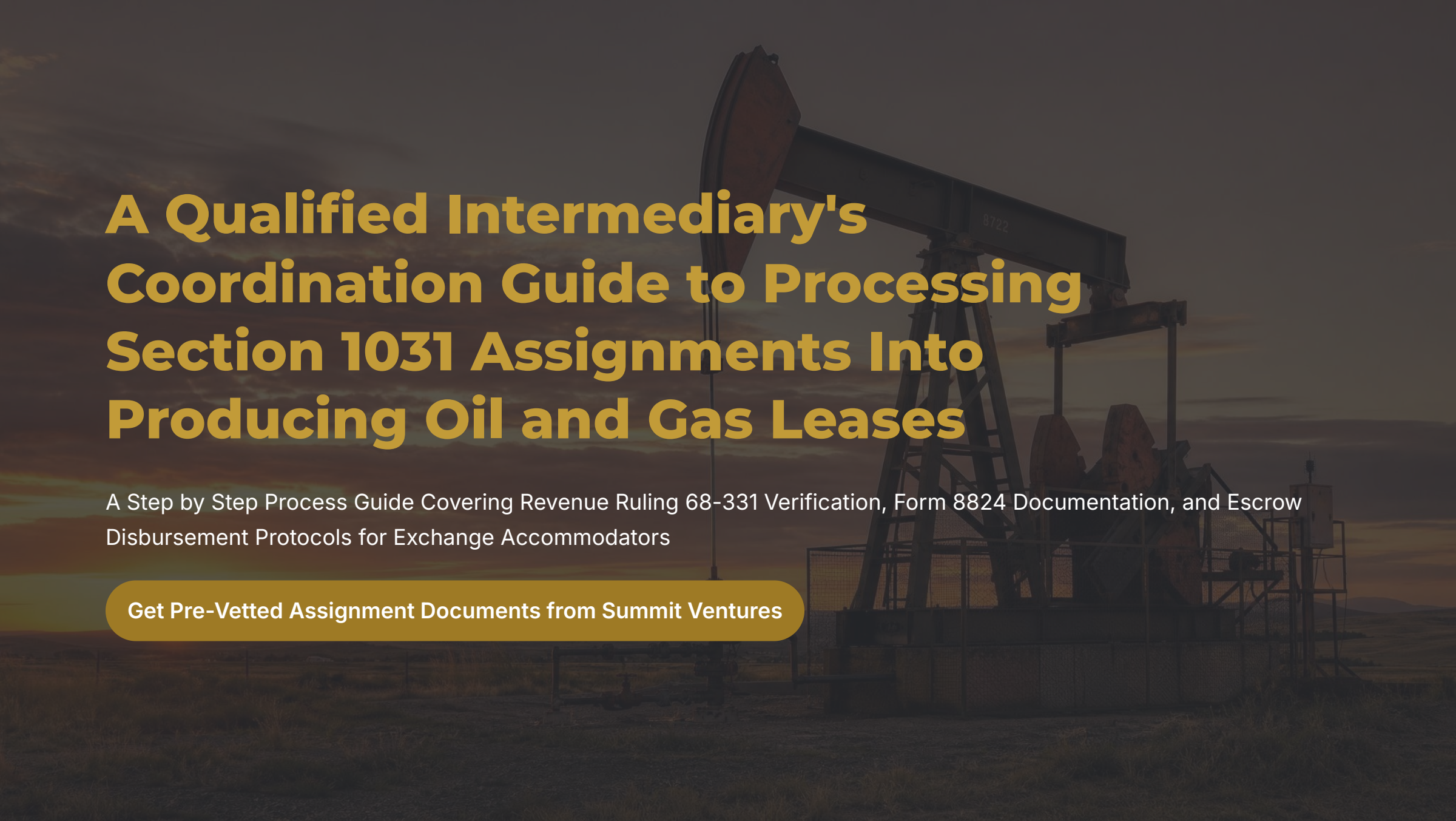

A Qualified Intermediary's Coordination Guide to Processing Section 1031 Assignments Into Producing Oil and Gas Leases

A Step by Step Process Guide Covering Revenue Ruling 68-331 Verification, Form 8824 Documentation, and Escrow Disbursement Protocols for Exchange Accommodators

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Purpose

Exchange accommodators administering complex commercial and land exchanges are seeing a recurring pattern: a primary real estate replacement contract falls out of escrow in the final days before the Day 45 identification deadline, and the exchanger has no verified alternative real property option left to identify in writing. A direct assignment of a working interest in a producing oil and gas lease is one of the few categories of replacement property with a long-settled federal ruling directly on point: **Revenue Ruling 68-331 (1968-1 C.B. 352)** held that a lessee's working interest in a producing oil lease, held for productive use in a trade or business or for investment, is property of a like kind to a fee interest in real estate for purposes of Section 1031(a).

This guide gives a Qualified Intermediary's exchange administration team a standardized, repeatable verification protocol for processing that specific transaction type. The objective is not to make a legal or tax determination on any exchanger's individual fact pattern. The objective is to give the QI's back office a consistent internal sequence for confirming that a leasehold assignment identified as replacement property is documented, titled, and disbursed in a manner consistent with the qualified intermediary safe harbor before any exchange funds move.

Standardized Protocol

A repeatable verification sequence for the QI's back office — not a tax or legal determination.

Revenue Ruling 68-331

Long-settled federal authority holding working interests like-kind to fee real estate under §1031(a).

Safe Harbor Compliance

Ensures documentation, titling, and disbursement are consistent with the QI safe harbor before funds move.

Scope & Prerequisites

This Protocol Applies To

- Direct assignment of an operating or working interest in a producing lease to the exchanger as identified replacement property
- Exchanges where the QI already holds relinquished property proceeds in a qualified escrow or qualified trust account
- Coordination between the QI's exchange officer, the assignor or operator, the exchanger's CPA, and the closing or escrow agent handling the assignment

This Protocol Does NOT Cover

- Overriding royalty interests or mineral interests with no working interest component, which rest on a separate ruling basis (Revenue Ruling 72-117) and separate qualification analysis
- Fund, limited partnership, or multi-member LLC interests, which do not transfer direct title to real property and generally fail the like-kind test regardless of what the underlying entity owns
- Preparation of the exchanger's tax return or a legal opinion on the exchanger's specific facts, both of which remain the responsibility of the exchanger's own CPA and attorney

Prerequisites — Must Be in Place Before This Protocol Begins

A written exchange agreement between the QI and the exchanger, executed **before** the relinquished property transferred

Confirmation that the QI is not a disqualified person under Treas. Reg. 1.1031(k)-1(k) relative to this exchanger

A qualified escrow account or qualified trust account already holding the relinquished property proceeds, structured so the exchanger has no right to receive, pledge, or borrow against the funds except as permitted under the safe harbor

Sufficient days remaining in the 45 day identification window, or a properly completed written identification already on file

Required Inputs & Tools



Exchange Agreement & Closing Statement

Relinquished property closing statement and the executed exchange agreement confirming QI engagement timing.



Written Identification Document

The exchanger's written, signed identification describing the leasehold interest with enough specificity to be unambiguous — lease name, well or unit name, county and state, and API number where available.



Draft Assignment Instrument

Transferring the working interest directly from the assignor to the exchanger. Summit Ventures provides pre-vetted instruments formatted to QI documentation standards.



Legal Opinion Letter

Addressing the interest's qualification as real property under the Revenue Ruling 68-331 analysis. Summit Ventures provides pre-vetted letters that reduce the verification burden on the QI's own file review.



Title Opinion & Division Order

Title opinion or division order information on the leasehold confirming the assignor's authority to convey.



Form 8824 Worksheet & Basis Schedule

From the exchanger's CPA, along with a written escrow disbursement instruction template signed by the exchanger.

Process Overview

The protocol runs in three phases. Phase one confirms the identified interest actually qualifies as real property under the exchange rules before any document is drafted. Phase two confirms the assignment instrument and supporting title documentation are complete and run directly between the correct parties. Phase three confirms disbursement from the qualified escrow or trust account is authorized correctly and that the documentation package needed for Form 8824 is compiled and handed to the exchanger's CPA.



Qualify Interest

Verify Assignment

Disburse & Document

Step-by-Step Process: Steps 1–4

1 Confirm Exchange Agreement and Timing

Verify the QI was engaged before the relinquished property closed and that exchange proceeds were transferred directly into the qualified escrow or qualified trust account rather than to the exchanger. A Qualified Intermediary is a person who is not the taxpayer or a disqualified person and who enters into a written exchange agreement under which it acquires and transfers the relinquished property and acquires and transfers the replacement property, and is treated as doing so because it holds and transfers legal title, regardless of whether it is the taxpayer's agent under state law.

2 Verify the Identification Document Describes a Qualifying Interest

Confirm the written identification names a specific working interest (not a royalty, overriding royalty, or net profits interest) and describes it unambiguously. Cross check this identification against the Three Property, 200 Percent, or 95 Percent identification rule the exchanger is relying on for this exchange, since adding a leasehold interest to an existing identification list can push the file over the applicable limit.

3 Confirm Direct Holding, Not an Entity Interest

Confirm the exchanger will take title to the working interest directly, or through an entity that does not limit liability, rather than acquiring a fund unit, LP interest, or membership interest in a multi-member LLC. A partnership, LLC, or fund interest does not qualify as like-kind real property even when the underlying entity owns a qualifying lease, because the exchanger would be acquiring an entity interest, not title to the real property itself.

4 Request and Review the Legal Opinion Letter and Assignment Instrument

Obtain the assignor's legal opinion letter addressing the Revenue Ruling 68-331 qualification analysis and the draft assignment instrument. Confirm the assignment runs directly from the assignor or operator to the exchanger's name as it will appear on the identification document, consistent with how a delayed exchange deed is typically drafted to run directly from the original seller to the exchanger's client rather than through the QI's own title.

Step-by-Step Process: Steps 5–7

1 Reconcile Consideration and Prepare Disbursement Instructions

Confirm the consideration stated in the assignment instrument matches the funds available in the qualified escrow or qualified trust account, net of any prior disbursements. Prepare a written disbursement instruction, signed by the exchanger, stating the account number, amount requested, and transfer instructions, since withdrawals from a qualified escrow or trust account are strictly monitored against this written authorization. Industry best practice treats exchange funds as client trust funds held separately from the QI's own corporate accounts, never commingled with the QI's general assets.

2 Execute the Assignment and Confirm No Constructive Receipt Occurred

Confirm funds moved directly from the qualified escrow or trust account to the assignor or closing agent, and that the exchanger had no right to the money before the end of the exchange period, except after day 45 if nothing was identified, after the exchanger receives all identified property, or after a written, material contingency beyond the exchanger's control. Record the closing date for Form 8824 purposes.

3 Compile the Form 8824 Documentation Package

Assemble the executed assignment, legal opinion letter, closing statement, and identification document into a single file and deliver it to the exchanger's CPA. Form 8824 is used to report each exchange of business or investment real property for real property of a like kind and figures the amount of gain deferred as a result of the exchange. If the exchanger transferred and received more than one group of like-kind properties, or cash or other non-like-kind property, the standard line entries are not completed and a separate statement showing how the realized and recognized gain was figured must be attached instead.

⚠ Funds must never move before Steps 1–5 are fully verified. Premature disbursement can trigger constructive receipt and convert the exchange into a fully taxable sale.

Decision Points & Roles

Critical Decision Points

- Does the identified property describe a **working interest**, or only a royalty or overriding royalty interest? The qualification analysis differs between the two.
- Will the exchanger hold title **directly**, or through a liability-limiting entity that would disqualify the interest as like-kind real property?
- Does adding the leasehold assignment to the identification list **exceed the Three Property, 200 Percent, or 95 Percent limit** already in use for this exchange?
- Is the assignor, operator, or any party to the assignment a **disqualified person** relative to this exchanger under the two year lookback rule?
- Is the transaction still inside the **concurrent 45 day and 180 day window**, or does the file need to be referred to the exchanger's counsel for a boot or recognized gain discussion?

Roles & Responsibilities

QI Exchange Officer

Holds qualified escrow or trust funds, verifies identification and assignment documentation, authorizes disbursement, and confirms the QI remains a non-disqualified party throughout.

Exchanger's CPA

Prepares Form 8824, confirms basis allocation, and determines whether any gain is recognized.

Exchanger's Tax or Legal Counsel

Reviews the legal opinion letter and confirms how the Revenue Ruling 68-331 analysis applies to this exchanger's specific fact pattern.

Assignor or Operator

Provides the title opinion, division order information, assignment instrument, and legal opinion letter. Where Summit Ventures is the assigning party, these documents are pre-vetted and formatted to QI compliance standards.

Escrow or Qualified Trust Holder

Executes disbursement strictly according to the exchanger's written instruction and the terms of the qualified escrow agreement.

Common Problems & Quality Checks

Common Problems to Avoid

Royalty vs. Working Interest Confusion

Treating a royalty only or overriding royalty identification as interchangeable with a working interest identification, when the two rest on different rulings and different qualification tests.

Entity Interest Title Failure

Allowing the exchanger to take title through a fund unit, LP interest, or multi-member LLC interest rather than a direct assignment, which forfeits like-kind treatment even though the underlying asset is a producing lease.

Missed Day 45 Deadline

Missing the written, signed, and delivered identification requirement before midnight on Day 45, measured in calendar days with no extension outside a federally declared disaster.

Disqualified Person Oversight

A person who has acted as the exchanger's employee, attorney, accountant, investment banker, broker, or real estate agent within the two year period ending on the date of the first relinquished property transfer is treated as an agent of the exchanger and is therefore disqualified from serving in a role protected by the safe harbor, though routine title insurance, escrow, or trust services do not by themselves create this conflict.

Constructive Receipt Breach

An escrow or disbursement instruction broad enough to give the exchanger an unrestricted right to draw upon the funds before closing breaks the qualified escrow safe harbor and causes the exchanger to be in constructive receipt, converting the transaction into a taxable sale rather than a deferred exchange.

Incomplete Form 8824 Reporting

Omitting the required supporting statement on Form 8824 when the exchange involved multiple assets or any boot, rather than relying on the standard line entries alone.

Pre-Disbursement Quality Checklist

- ☐ The identification document is written, signed, dated, and was delivered to the QI or another non-disqualified party before the Day 45 deadline.
- ☐ The assignment instrument names the exchanger directly as assignee and matches the legal description on the identification document.
- ☐ The legal opinion letter addresses the working interest qualification under Revenue Ruling 68-331 and is dated on or before the assignment.
- ☐ The consideration in the assignment matches the funds held in the qualified escrow or qualified trust account, with no discrepancy left unexplained.
- ☐ No party to the assignment is a disqualified person relative to the exchanger.
- ☐ The disbursement instruction is signed by the exchanger and limited to the specific amount, account, and closing date.
- ☐ A complete documentation package — including the closing statement, identification document, assignment, and legal opinion letter — is ready to hand to the exchanger's CPA for Form 8824 preparation.

Expected Outcome, Key Questions & Sources

A correctly processed file shows an unbroken chain from the exchanger's written identification, through a verified working interest assignment running directly from the assignor to the exchanger, through disbursement from the qualified escrow or trust account with no constructive receipt exposure, to a complete documentation package delivered to the exchanger's CPA in time for Form 8824 preparation. The QI's own exposure is limited to the administrative verification role described in this protocol; it is not a party to the substantive tax determination, which remains with the exchanger's CPA and counsel.

Exchange accommodators who build this verification sequence into their standard back-office workflow are not making a tax determination on behalf of any exchanger. They are simply ensuring that when a producing lease assignment is identified as replacement property — usually under time pressure after a primary contract has fallen through — the file is handled with the same documentation discipline applied to any other replacement property. Exchangers and their advisors remain responsible for the ultimate qualification determination, and QIs should continue directing exchangers to independent tax and legal counsel before any assignment is finalized. For QIs evaluating assignors who offer producing lease interests as a documented replacement property option, reviewing how that assignor's legal opinion letters and assignment instruments are structured **before** a Day 45 deadline arrives, rather than during it, remains the most reliable way to keep this protocol fast when it is actually needed.

Final Checklist Questions

- Has the identification document been reviewed against the specific identification rule (Three Property, 200 Percent, or 95 Percent) already governing this exchange file?
- Does the assignment instrument transfer a direct working interest, or does it convey an entity interest that would need to be re-papered before closing?
- Has the assignor's legal opinion letter been dated, reviewed, and placed in the file before the disbursement instruction is prepared?
- Has every party to the assignment been checked against the two year disqualified person lookback?
- Is there enough time remaining in the 45 day or 180 day window to complete this assignment, or should the exchanger's counsel be consulted on a boot or recognized gain contingency now rather than later?
- Has the exchanger's CPA confirmed what supporting statement, if any, is needed on Form 8824 for this specific transaction?

Sources & References

- **Revenue Ruling 68-331**, 1968-1 C.B. 352 — holding that a lessee's working interest in a producing oil lease held for productive use in a trade or business or investment is like-kind to a fee interest in real estate under Section 1031(a)
- **Treas. Reg. 1.1031(k)-1(g)(3) through (g)(4)** — governing qualified escrow accounts, qualified trusts, and the qualified intermediary safe harbor
- **Treas. Reg. 1.1031(k)-1(k)** — defining disqualified persons, including the two year lookback
- **IRS Instructions for Form 8824** (2025 and 2026) — Like-Kind Exchanges, multi-asset exchange reporting statement requirement, and related party exchange reporting rules
- First American Exchange Company — on QI engagement timing and the qualified escrow safe harbor mechanics
- Atlas 1031 and Exeter 1031 Exchange Services — on qualified escrow and qualified trust account disbursement practices
- Breakwater Exchange — on the conditions under which the safe harbor ceases to apply and a taxpayer is treated as in constructive receipt

> Summit Ventures provides pre-vetted legal opinion letters and direct leasehold assignment instruments formatted to QI documentation standards — reducing the verification burden on the QI's own file review and keeping this protocol fast when a Day 45 deadline is approaching.

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