

Tax-Aware Direct Working Interest Participation for Private Pilots

An Analytical White Paper Examining IRC Section 263(c) and Section 469(c)(3), Statutory Tax Mechanics, and Direct Energy Ownership Considerations for High-Earning Aviators

WHITE PAPER

SUMMIT VENTURES

Executive Summary

Professional pilots occupy an unusual position in the U.S. tax system. Captains and senior first officers at major passenger and cargo carriers, along with corporate and charter pilots flying for private flight departments, now routinely earn base pay, per diem, profit-sharing, and bonus compensation that places them squarely inside the top federal marginal bracket, yet their income is almost entirely W-2 in character and their work schedules are federally regulated down to the hour. This combination — high active income with limited schedule flexibility — creates a narrow set of statutory options for managing tax exposure, and it rules out several strategies that other high earners use.

Section 263(c)

Governs the election to deduct intangible drilling costs (IDC) in the year incurred rather than capitalizing them — a **timing and classification election**.

Section 469(c)(3)

The working interest exception to the passive activity loss rules that actually permits an otherwise passive-activity deduction to **offset active income** such as flight pay, profit-sharing distributions, and bonus compensation.

This white paper examines both provisions — frequently confused with one another but serving distinct functions — along with the statutory layers that modify how much of a deduction is usable in a given year, including the at-risk rules under Section 465, the alternative minimum tax preference under Section 57(a)(2), the economic performance timing rule under Section 461(h), and the percentage depletion allowance under Sections 611 and 613A. The objective is educational: to give pilots and the professionals who advise them a technically accurate foundation for evaluating direct working interest participation in domestic oil and gas development as part of a broader tax and capital planning conversation, not to promise a specific outcome.

Why This Issue Matters

Pay at the major U.S. passenger carriers has moved sharply higher since 2023. Industry data compiled in early 2026 shows senior widebody captains at the U.S. majors routinely clearing **$400,000 to $550,000 or more per year**, including base pay, overtime premiums, profit-sharing, and generous retirement contributions. At Delta specifically, senior captains can see total annual packages rise above $500,000 and toward $539,000 once profit-sharing and retirement contributions are included. Cargo captains at FedEx and UPS, narrow-body captains at Southwest, Alaska, and JetBlue, and corporate or charter pilots flying for private flight departments occupy a wide range of compensation levels, but the pattern at the senior end of the profession is consistent: a mix of hourly flight pay, per diem, holiday and premium pay, and in many cases an annual profit-sharing distribution that can itself represent a six-figure lump sum.

Nearly all of this income arrives as W-2 wages or, for a smaller number of corporate pilots structured as contractors, 1099 compensation. Unlike a business owner who controls a personal calendar, a pilot generally cannot shift the character of this income, defer it across tax years at will, or generate offsetting losses from a side activity that requires an open-ended weekly time commitment. The schedule itself is the constraint. A pilot's work year is governed by federal flight-time and duty-time regulation, not by personal discretion, which eliminates several of the conventional strategies that depend on logging substantial personal hours in a separate trade or business.

$539K

Delta Senior Captain

Total annual package including profit-sharing and retirement contributions

1,000

Max Flight Hours/Year

Federal cap on annual flight hours per FAA regulation

37%

Top Federal Bracket

Marginal rate made permanent under the One Big Beautiful Bill Act

The Three Structural Challenges

Three structural facts combine to create the exposure this paper addresses.

Top Marginal Bracket Exposure

Top marginal bracket exposure is now a routine feature of senior pilot compensation, not an occasional event. A captain whose base pay, premium flying, and a single profit-sharing distribution combine to exceed roughly **$640,600 in a given tax year as a single filer, or $768,600 for a married couple filing jointly** — the 2026 thresholds for the top 37 percent federal bracket made permanent under the One Big Beautiful Bill Act (OBBBA) — faces the same marginal rate on that income as any other high earner, with no mechanism to average it across years or defer its recognition.

Conventional Deferral Vehicles Are Capped

For 2026, the IRS has set the 401(k) employee elective deferral limit at **$24,500**, the combined employee-and-employer limit at **$72,000**, and the standard IRA contribution limit at **$7,500**, with a Roth IRA phase-out beginning at $153,000 of modified adjusted gross income for a single filer and $242,000 for a married couple filing jointly. A captain earning several hundred thousand dollars in a year in which a profit-sharing distribution lands cannot meaningfully reduce taxable income through retirement deferral alone, and in many cases is already phased out of direct Roth contributions entirely.

Hours-Based Strategies Are Unavailable

Federal rules cap flying at **100 hours per 28 days and 1,000 hours per year**, which is why pay scales are built around hourly rates rather than a fixed salary. Total duty time, including report time, turns, and standby, is also regulated directly. No certificate holder may schedule and no flightcrew member may accept an assignment if the flightcrew member's total flight duty period will exceed **60 flight duty period hours in any 168 consecutive hours or 190 flight duty period hours in any 672 consecutive hours**. Reserve assignments, seniority-based bidding, and mandatory rest periods under 14 CFR Part 117 leave little room for a pilot to independently log the kind of ongoing weekly hours that other statutory tests require. A real estate professional, for example, must satisfy a 750-hour annual threshold and demonstrate that more than half of personal service time is spent in real property trades — a bar that is effectively closed to a line pilot or reserve captain whose own schedule is dictated by an FAA-regulated duty roster.

This is the practical gap this paper's subject matter is built to address: a statutory mechanism that does not depend on an hours test at all.

Background and Context

Historical Roots of IDC Expensing

The IDC expensing election traces to a **1916 Treasury regulation** and was codified as part of the Internal Revenue Code of 1954, making it one of the oldest continuously available deductions in the federal tax code — and one that has survived numerous subsequent reform efforts, including the Tax Reform Act of 1986. That 1986 legislation is itself significant to this discussion, because it is the same law that introduced the passive activity loss rules under Section 469, rules that, as a general matter, prevent losses from activities in which a taxpayer does not materially participate from offsetting W-2 wages, 1099 income, or K-1 distributions classified as active.

Congress built a specific, narrow exception into that same legislation for working interests in oil and gas properties, recognizing that the economics of drilling activity did not fit the general passive-loss framework.

Current Market Context

Oil and natural gas provide approximately **80 percent of American energy** on a historical multi-source basis, and the United States has continued to set domestic production records through the middle of this decade — a trend that underpins the ongoing capital needs of domestic drilling programs that rely on direct working interest participation for a portion of their funding.

The OBBBA, signed into law in 2025, separately made **100 percent bonus depreciation under Section 168(k) permanent** for qualifying tangible property, reversing a scheduled phase-down and reinforcing the broader federal policy of favorable timing treatment for domestic energy development costs, which operates alongside — but is legally distinct from — the IDC election discussed in this paper.

> A working interest in an oil or gas property is a direct ownership right in the mineral lease that carries both the obligation to pay a share of drilling and operating costs and the right to a share of production revenue, net of royalty.

Drilling costs on a working interest fall into two categories for tax purposes. **Intangible drilling costs (IDC)** are costs with no salvage value, including labor, drilling fluids, chemicals, site preparation, and hauling. **Tangible drilling costs (TDC)**, such as casing, wellhead equipment, and storage tanks, retain salvage value and are capitalized and recovered through depreciation. Treasury Regulation 1.612-4, issued under IRC Section 263(c), allows a working interest holder to elect to expense IDC in the year incurred rather than capitalizing and recovering those costs over the life of the well.

Statutory Analysis: The Key Code Sections

1	**Section 263(c): The Deduction Timing Election** Section 263(c) and its underlying regulation answer a narrow question: may a working interest holder expense IDC in the year incurred, or must those costs be capitalized? The election answers a **timing and classification question**. It does not, by itself, determine whether the resulting deduction can offset active income. That determination is governed by Section 469(c)(3), and the two provisions are frequently conflated in general tax commentary in a way that understates the importance of how an interest is held.
2	**Section 469(c)(3): Offsetting Active Income** The passive activity loss rules generally classify a working interest as a passive activity unless the taxpayer materially participates. Section 469(c)(3)(A) creates a specific statutory exception: the passive activity definition *"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 with respect to such interest."* Two consequences follow: **no material participation or hours test applies**, and the exception is **lost entirely if the interest is held through a liability-limiting entity** such as an LLC or limited partnership.
3	**Section 465: The At-Risk Limitation** Even where Section 469(c)(3) preserves active-income treatment, Section 465 separately limits the deduction to the amount of the participant's actual economic exposure, calculated as cash contributed plus qualifying recourse debt for which the participant is personally liable. Nonrecourse financing — a structure permitted in some real estate contexts — does not increase at-risk basis for a working interest, which means the deduction tracks real capital exposure rather than a leveraged theoretical figure.
4	**Section 57(a)(2): The AMT Interaction** Excess IDC — defined generally as the amount by which IDC expensed under Section 263(c) exceeds the amount that would have been allowed under ratable amortization — is a tax preference item under Section 57(a)(2)(A) only to the extent it exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties for that year. A separate provision, Section 57(a)(2)(E), allows independent producers to elect to reduce this preference, subject to its own cap: the resulting reduction in alternative minimum taxable income cannot exceed **40 percent of AMTI** computed without regard to that election. These are two distinct thresholds governing two different calculations, not one figure described two ways, and both should be modeled individually by a CPA.
5	**Section 461(h) and the Order of Loss Limitations** Section 461(h), the economic performance rule, generally requires that drilling activity actually occur, subject to a limited exception allowing certain prepaid IDC to be deducted if drilling commences within **90 days** — a timing detail that matters for year-end capital contribution decisions. A participant's usable deduction in any year is determined by working through four layers in sequence: basis limitation, then the Section 465 at-risk limitation, then the Section 469 passive activity rules (bypassed here by the working interest exception), and finally the Section 461(l) excess business loss limitation, which caps the amount of business loss that can offset nonbusiness income at **$256,000 for a single filer or $512,000 for a married couple filing jointly in 2026**, with any excess carried forward as a net operating loss.
6	**Sections 611 and 613A: Percentage Depletion** Once a well produces, independent producers may generally claim **percentage depletion of 15 percent of gross income** from the property — an ongoing benefit that continues even after the participant's cost basis in the property has been fully recovered, which distinguishes it from cost-based depreciation.

What the Statute Does Not Shelter

Two limits deserve direct statement rather than implication.

Self-Employment Tax

Section 469(c)(3) addresses the passive activity classification of the loss, **not self-employment tax**. A line of authority including *Methvin v. Commissioner* has examined when working interest income itself may carry self-employment tax consequences depending on the specific facts of participation — which is a separate analysis from the income-offset question addressed here.

Liability-Limited Structures Forfeit the Exception

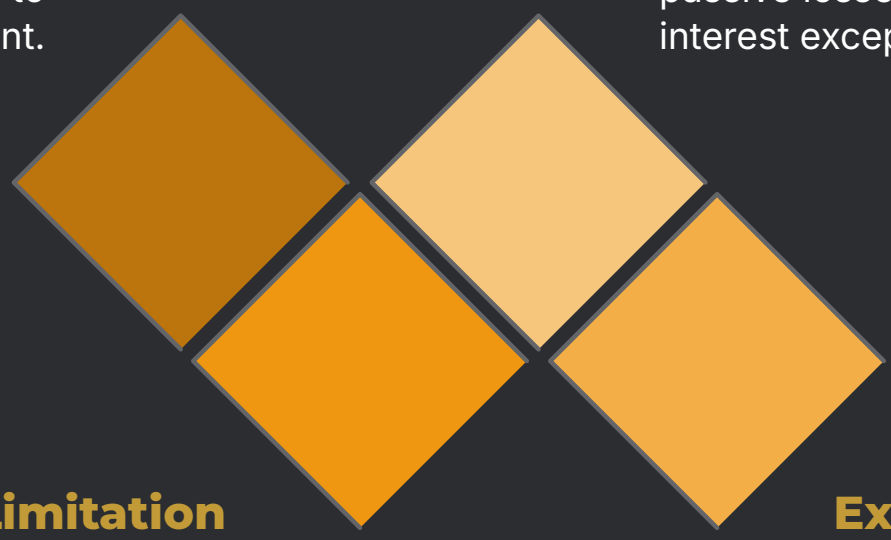
The active-income offset is only available for as long as the interest is held directly, or through an entity that does not limit the holder's liability. A pooled structure that limits liability **forecloses the exception entirely**, regardless of the quality of the underlying asset. A membership interest in an LLC or a limited partnership unit is not itself a direct working interest, and income or loss from that unit reverts to passive-activity treatment regardless of the underlying asset.

At-Risk Limitation

Section 465 limits losses to at-risk amount.

Passive Activity Rules

Section 469 disallows passive losses; working interest exception applies.



Basis Limitation

Loss limited to taxpayer's basis in activity.

Excess Business Loss Cap

Section 461(l) caps deductible business losses.

The Summit Ventures Structure: How Direct Working Interest Participation Is Organized

Summit Ventures organizes its energy ownership opportunities around a **direct working-interest joint venture model** built specifically to preserve the statutory conditions described above, rather than around a pooled, liability-limited vehicle. The structure rests on four elements.

Direct Assignment of Working Interest

Rather than a membership or partnership unit, each participant is the actual holder of record of the interest and the liability that accompanies it, consistent with the language of Section 469(c)(3)(A).

AFE Cost Allocation Documentation

Cost allocation documented through the Authorization for Expenditure (AFE) process itemizes intangible and tangible costs separately at the project level so that a participant's accountant can apply Section 263(c) and the at-risk calculation to verified, well-specific figures rather than an industry average.

Governance Rights and Operational Transparency

As a working interest owner, a participant has access to the joint operating agreement governing the well, receives operational reporting, and holds the rights attached to direct ownership rather than the more limited information rights typical of a pooled program interest holder.

Clean K-1 Reporting

K-1 reporting reflects the active classification of the participant's share of income and deduction, consistent with direct working interest treatment, giving the participant's CPA a clean basis for return preparation rather than requiring a reclassification analysis after the fact.

For a pilot specifically, this structure is relevant because it does not require material participation hours, scheduled availability, or any ongoing weekly time commitment beyond the governance rights the participant chooses to exercise — which aligns with the practical reality of a federally regulated flight and duty schedule.

Recommendations: A Five-Step Evaluation Sequence

A pilot evaluating this structure, together with a CPA, should generally work through the following sequence before any capital contribution decision.

1 Model the Specific Tax Year

Model the specific tax year in which a liquidity event — such as a profit-sharing distribution, a signing or retention bonus, a lump-sum deferred compensation payout, or proceeds from the sale of a flight-related business interest — will land, since the AMT thresholds, the 461(l) excess business loss cap, and the at-risk calculation under Section 465 are all computed on an annual basis and the usable deduction will vary by year depending on total active income.

2 Confirm the Entity Structure

Confirm the entity structure of any specific opportunity before contributing capital. If the interest is held through a liability-limiting LLC or LP rather than directly, the Section 469(c)(3) exception does not apply and the resulting loss reverts to passive-activity treatment, usable only against income the tax code classifies as passive.

3 Request the Well-Specific AFE

Request the AFE for the specific well — not an industry-wide estimate — since the intangible-versus-tangible cost split varies by project and determines the actual Section 263(c) deduction available, and confirm the at-risk basis calculation reflects cash contributed and any qualifying recourse obligation.

4 Coordinate Timing Under Section 461(h)

Coordinate timing with a CPA around the 90-day drilling exception under Section 461(h) if a year-end capital contribution is being considered, since a contribution made late in a tax year may not qualify for that year's deduction unless drilling begins within the statutory window.

5 Treat Percentage Depletion as Multi-Year Planning

Treat percentage depletion under Sections 611 and 613A as a multi-year planning consideration rather than a one-time event, since it continues to apply to production income in years after the well is drilled and after the participant's cost basis has been recovered.

Questions for Professional Advisor Discussion

The following questions are designed to structure a productive conversation between a pilot and their CPA or tax advisor when evaluating a direct working interest opportunity.

Question 1 — Bracket Proximity

Given my specific compensation mix this year, including base pay, per diem, and any profit-sharing or bonus distribution, how close am I to the 2026 top marginal bracket threshold, and does the timing of a capital contribution change that outcome?

Question 2 — Entity Structure

Is the working interest being offered to me held directly, or through an LLC or LP that would limit my liability and therefore forfeit the Section 469(c)(3) exception?

Question 3 — AFE Cost Split

What does the AFE for this specific well show as the intangible-versus-tangible cost split, and how does that compare to the industry range cited in independent sources?

Question 4 — At-Risk Basis

How does my at-risk basis under Section 465 compare to the capital I am contributing, and does any portion of my contribution fail to qualify as at-risk capital?

Question 5 — AMT Thresholds

Does my excess IDC for the year exceed 65 percent of my net oil and gas property income under Section 57(a)(2)(A), and if I am treated as an independent producer, how does the separate 40 percent of AMTI limitation under Section 57(a)(2)(E) apply to my specific return?

Question 6 — 90-Day Drilling Window

If I am contributing capital late in the calendar year, does the well's planned spud date fall within the 90-day window required under Section 461(h) for that year's IDC deduction?

Question 7 — Excess Business Loss Cap

How does the Section 461(l) excess business loss limitation — $256,000 for a single filer or $512,000 for a married couple filing jointly in 2026 — interact with any other business losses I may already be carrying?

Question 8 — Governance Rights

What governance rights and reporting do I receive as a direct working interest holder, and how do those rights support the liability and operational facts my CPA needs to document the Section 469(c)(3) position on my return?