

Why Business Attorneys Face a Narrowing Tax Window

An Analytical White Paper Examining Statutory Tax Mechanics, Direct Energy Ownership Structures, and Strategic Considerations for Business Attorneys With High Active Income or Liquidity Events

WHITE PAPER

SUMMIT VENTURES

Executive Summary

Business attorneys, particularly equity partners in corporate, transactional, and mergers and acquisitions practice groups, routinely generate income that concentrates at the top of the federal tax structure. Partnership distributive shares reported on Schedule K-1, origination and billable-hour bonus pools, success fees tied to closed transactions, and capital account distributions that follow a partner buyout, firm merger, or sale of a book of business all tend to land in a single tax year rather than spreading evenly across twelve months.

For 2026, the top federal ordinary rate of **37 percent** applies above **$640,600** of taxable income for single filers and **$768,700** for married filing jointly, thresholds made permanent under the One Big Beautiful Bill Act (OBBBA) of 2025. Conventional deferral tools, including 401(k) elective deferrals capped at $24,500 for 2026 with a $72,000 combined employer-and-employee ceiling, were not designed to offset income at the scale many business law partners realize in a single calendar year.

IRC Section 263(c)

Governs the **timing and classification** of intangible drilling cost (IDC) deductions — when and how those costs are expensed.

IRC Section 469(c)(3)

The separate, narrower provision that determines whether IDC deductions can **offset active income** — including W-2 wages, 1099 compensation, and K-1 distributive shares — rather than being quarantined to passive income only.

This white paper walks through the statutory mechanics, the entity-structure requirements that preserve the exception, the related limitations a business attorney and counsel should understand, and how Summit Ventures structures direct working interest participation to keep those statutory elements intact.

Why This Issue Matters to Business Attorneys

Business attorneys occupy an unusual position among high-income professionals. Many spend their careers advising clients on entity structure, tax treatment, and liquidity events, yet their own compensation often follows an uneven, concentrated pattern that creates exactly the kind of planning problem they counsel clients to address.

Concentrated K-1 Distributive Shares

A corporate partner's distributive share can swing meaningfully from year to year based on closed deal volume, landing in a single tax year with no averaging mechanism.

Contingency & Success Fees

A business litigator working on a contingency or success-fee basis may realize several years of effort as a single lump-sum payment in one filing year.

Equity Stakes from Client Engagements

An M&A or venture-side attorney who accepts an equity stake in lieu of cash fees may face a significant liquidity event when that company is acquired or completes a public offering.

Partnership Transitions

Partnership withdrawal, retirement, or a firm merger can trigger a capital account distribution concentrated in one filing year with limited advance notice.

There is also a structural irony specific to this audience. Attorneys, perhaps more than any other profession, are accustomed to tracking hours with precision, because the billable hour is the currency of the practice. Yet when it comes to several hours-based tax provisions available to other taxpayers, that same precision works against them. Real estate professional status requires more than 750 hours of personal service in real property trades during the year and more than half of the taxpayer's total personal service hours spent in those trades — a standard that is effectively unreachable for an attorney already billing 2,000 or more hours annually in legal practice.

The working interest exception under IRC Section 469(c)(3) is structured differently. It requires **no material participation test and no minimum-hours threshold at all.** The determining factor is not how many hours the holder spends on the activity — it is how the interest is held.

The Problem: Structural Tax Exposure With Few Statutory Offsets

Three structural facts define the challenge for business attorneys evaluating their own tax position.

1 Income Concentration Meets a Flat Top Bracket

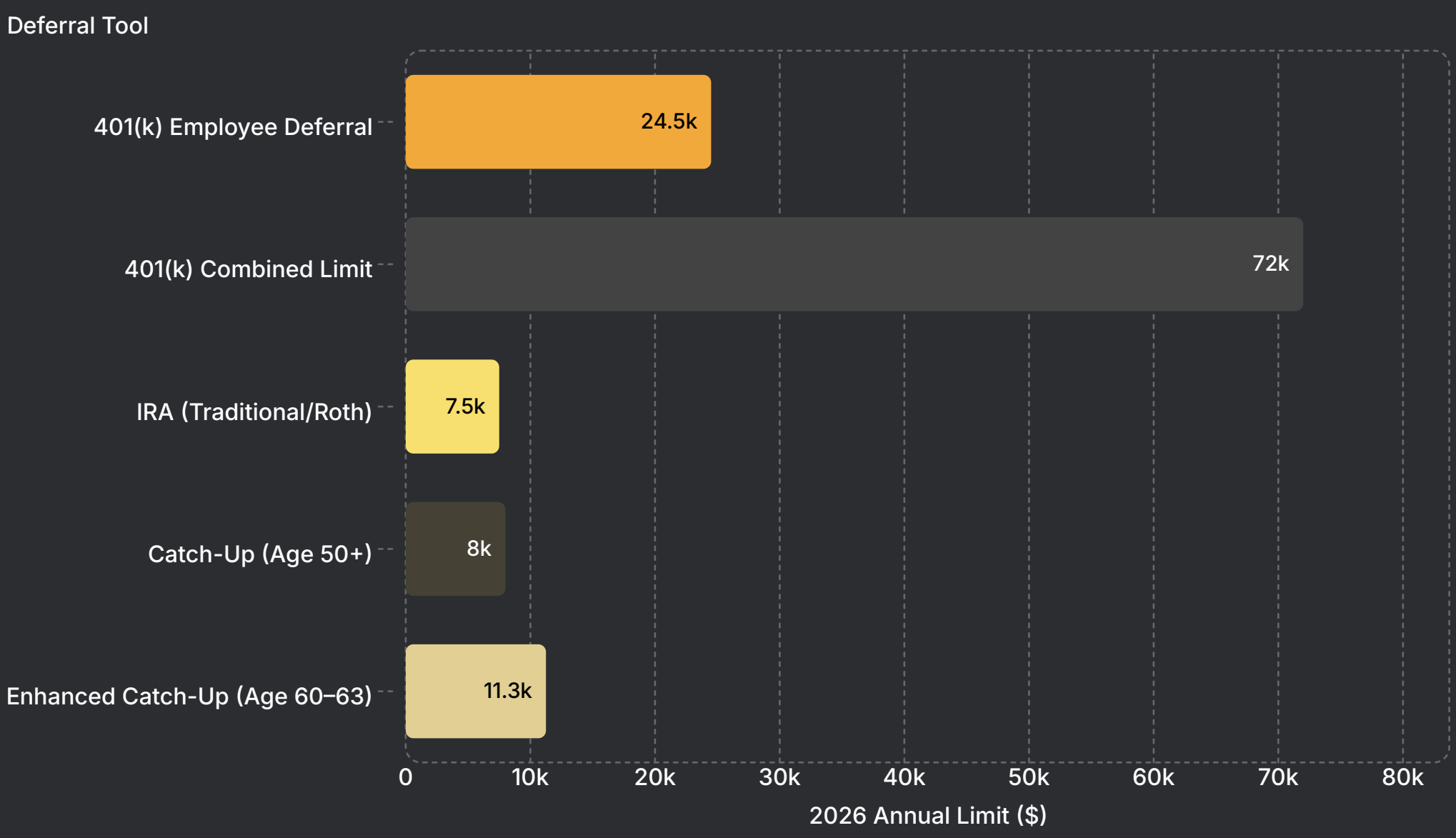
A corporate or M&A partner's K-1 distributive share, a contingency-fee recovery, or a partnership buyout payment is taxed at ordinary income rates in the year received, with no averaging mechanism comparable to what existed under prior law. Once taxable income crosses the 2026 thresholds of $640,600 single or $768,700 married filing jointly, every additional dollar is taxed at 37 percent federally, before considering state income tax in non-zero-tax jurisdictions.

2 Conventional Deferral Vehicles Do Not Scale

The 2026 IRS limits include a $24,500 401(k) employee deferral limit, a $72,000 combined employee-and-employer limit, an $8,000 catch-up contribution for participants age 50 and older, and an $11,250 enhanced catch-up for those age 60 through 63. A $7,500 traditional or Roth IRA limit applies separately, with Roth eligibility phasing out between $153,000 and $168,000 for single filers — a range many business attorneys exceed before any liquidity event even occurs.

3 Hours-Based Alternatives Are Functionally Closed

Real estate professional status is the most commonly cited example, and its 750-hour and majority-of-personal-service-time tests are difficult to reconcile with a full-time legal practice built around billable-hour targets. Without that status, rental real estate losses are generally limited to a $25,000 special allowance that phases out between $100,000 and $150,000 of modified adjusted gross income — a ceiling most business attorneys have already exceeded.



The result is a planning gap: a professional with substantial, often unpredictable active income, and very few statutory tools built with that income profile in mind.

Background: The Origin of the Statutory Framework

1916

U.S. Treasury issues guidance permitting expensing of intangible drilling costs — the earliest statutory ancestor of the modern IDC deduction.

1954

Intangible drilling cost deduction formally codified as **IRC Section 263(c)** in the Internal Revenue Code of 1954. Treasury Regulation 1.612-4 implements the election.

1986

Tax Reform Act introduces passive activity loss rules under IRC Section 469 — and simultaneously carves out the **working interest exception under Section 469(c)(3)(A)** for direct oil and gas ownership.

2017

Tax Cuts and Jobs Act passes without closing the working interest exception. Bonus depreciation under Section 168(k) introduced at 100%, beginning phase-down schedule.

2025

One Big Beautiful Bill Act (OBBBA) makes **100% bonus depreciation permanent** for qualifying property placed in service after January 19, 2025, and permanently extends 2026 ordinary income tax brackets.

The intangible drilling cost deduction has a long history in U.S. tax law, tracing to 1916 Treasury guidance and formally codified as IRC Section 263(c) in the Internal Revenue Code of 1954. Treasury Regulation 1.612-4 implements the election, defining an operator as a party holding a working or operating interest in a property, whether as a fee owner or under a lease or other contract granting operating rights, and permitting that operator to elect to expense intangible costs — labor, fuel, chemicals, site preparation, and similar non-salvageable costs — in the year incurred rather than capitalizing them.

This historical detail matters for business attorneys specifically, because it confirms the exception is a **deliberately narrow, documented statutory framework** rather than a drafting oversight. It has survived nearly four decades of subsequent tax legislation, including the Tax Cuts and Jobs Act of 2017 and the OBBBA of 2025, without being closed.

The Statutory Mechanics in Detail

Section 263(c) & Reg. 1.612-4 — The IDC Election

Intangible costs are distinguished from tangible costs by the absence of salvage value: labor, fuel, chemicals, and site preparation have no resale value once consumed, while casing, tubing, and surface equipment retain value and must be capitalized. The applicable intangible-versus-tangible split for any specific well is confirmed through the Authority for Expenditure (AFE) and supporting cost documentation — not a fixed percentage that applies uniformly across all wells.

Section 469(c)(3)(A) — The Entity-Structure Requirement

The statute requires that the working interest be held **directly by the taxpayer, or through an entity that does not limit the taxpayer's liability**, such as a general partnership. A working interest held through an LLC or limited partnership that shields the holder from liability generally forfeits the exception, reverting the activity to passive treatment. No material participation or minimum-hours test applies — the operative distinction is how the interest is held.

Section 465 — The At-Risk Limitation

Deductions are capped at the holder's actual economic exposure, meaning cash contributed and recourse debt for which the holder is personally liable. Nonrecourse financing generally does not count toward at-risk basis — a distinction that differs from certain real estate financing structures.

Section 57(a)(2) — The AMT Interaction

Excess intangible drilling costs are a tax preference item for AMT purposes. Under Section 57(a)(2)(A), excess IDC is treated as a preference item only to the extent it exceeds 65 percent of the taxpayer's net income from oil, gas, and geothermal properties. Under Section 57(a)(2)(E), independent producers may elect to reduce AMTI by the excess IDC amount, subject to a cap: the resulting AMTI reduction cannot exceed 40 percent of AMTI computed without regard to that election.

Section 461(h) — Economic Performance

For accrual-basis timing, the IDC deduction generally requires economic performance — drilling activity must occur within a defined window. A narrow exception permits certain prepaid drilling costs to be deducted in the year paid if drilling commences within **90 days of year-end**, a detail that becomes relevant when timing a capital contribution against a specific liquidity-event year.

Sections 611 & 613A — Percentage Depletion

Once a well begins producing, independent producers may generally claim a **15 percent percentage depletion allowance** against gross income from the property — an ongoing benefit distinct from the upfront IDC deduction and not limited to the original cost basis in the way cost depletion is.

⚠ The four-layer loss limitation order — basis limitations, Section 465 at-risk, Section 469 passive activity rules, and Section 461(l) excess business loss (set at $256,000 single / $512,000 MFJ for 2026) — must each be modeled against the specific contribution amount and the attorney's full tax picture for the year. Do not stop at the first layer.

Market Context: Why Direct Energy Participation Remains Relevant

13.8M

Barrels Per Day

U.S. crude oil production forecast for 2026, on track to set a further record according to the U.S. Energy Information Administration.

6.8M

Permian Basin BPD

Permian Basin output forecast near 6.8 million barrels per day, supporting the broader U.S. production record.

10.6M

American Jobs

The American Petroleum Institute estimates the oil and natural gas industry supported roughly 10.6 million American jobs.

$2.1T

Economic Contribution

The API separately estimated approximately $2.1 trillion contributed to the U.S. economy by the oil and natural gas industry.

None of this market activity guarantees any particular outcome for a given well or a given business participant, and this paper makes no projection about future production, pricing, or returns. It is offered only as context for why direct participation in domestic energy production remains an active area of entrepreneurial joint venture activity that business attorneys are increasingly asked to evaluate, whether for their own planning or on behalf of clients.

How Summit Ventures Structures Direct Working Interest Participation

Summit Ventures operates as an entrepreneurial joint venture platform built around direct working interest ownership rather than pooled, liability-limited structures. Four structural elements are maintained specifically to preserve the statutory framework described in this paper.

Direct Assignment of Working Interest

Direct assignment to the business participant — rather than issuance of a membership or limited partnership interest in a liability-shielding entity — is the mechanism by which the Section 469(c)(3)(A) requirement is addressed at the structural level.

AFE-Documented Cost Allocation

Cost allocation is documented through the Authority for Expenditure and related well engineering records, so that the intangible-versus-tangible cost split for any specific well is traceable to actual project documentation rather than a marketed percentage.

Governance Rights & Operational Transparency

Governance rights and operational transparency are built into the joint operating structure, giving active JV members visibility into drilling, completion, and production decisions — distinct from a fund structure where decision authority rests entirely with a third-party manager.

Active-Classification K-1 Reporting

K-1 reporting is prepared to reflect the active classification associated with a properly structured direct working interest, supporting the business participant's own tax preparation and the professional review their CPA or tax counsel will conduct.

For a business attorney specifically, this structure addresses the core problem identified earlier in this paper: it requires no material participation hours — which matters for a professional whose time is already committed to billable work — and it allows the capital contribution and resulting deduction to be timed, with professional guidance, against the specific tax year in which a liquidity event concentrates income. The structure does not eliminate the underlying tax liability from that liquidity event; it provides a statutory framework through which a portion of that year's active income can be offset, subject to the basis, at-risk, AMT, and excess business loss limitations described above.

Recommendations & Questions for Professional Advisor Discussion

Seven Recommendations

01

Model the Specific Liquidity-Event Year Early

A partnership buyout, merger payment, or contingency fee recovery date should be identified as early as possible so that any capital contribution and the associated IDC election can be timed within the same tax year under Section 461(h), ideally with the 90-day drilling exception confirmed in writing.

02

Confirm the Holding Structure in Writing

Before relying on active-income treatment, confirm with tax counsel that the specific structure holds the working interest directly or through an entity that does not limit liability, documented in the governing joint operating agreement.

03

Run the Full Four-Layer Calculation

Basis, at-risk limitation under Section 465, the Section 469(c)(3) exception, and the Section 461(l) excess business loss threshold should each be modeled against the specific contribution amount and the attorney's full tax picture for the year.

04

Address the AMT Interaction Explicitly

The 65 percent net-income and 40 percent AMTI thresholds under Section 57(a)(2) should be calculated for the specific year, particularly if the liquidity event itself may also affect AMT exposure independently.

05

Review Partnership Agreement & Firm Policy

Many law firm partnership agreements include provisions addressing outside business interests, conflicts, and disclosure obligations. Confirm that direct working interest participation does not implicate firm-specific restrictions before proceeding.

06

Treat Percentage Depletion as a Separate Consideration

The 15 percent depletion allowance under Sections 611 and 613A should be modeled as a distinct, later-stage benefit once a well reaches production — not combined with the upfront IDC deduction in a single estimate.

07

Document Governance Participation

Because the structure emphasizes active JV participation rather than a passive, fund-style arrangement, maintaining records of governance rights exercised and operational involvement supports the overall classification analysis.

Eight Questions for Your Tax Advisor

1. Does my specific holding structure satisfy the direct-ownership or unlimited-liability-entity requirement under IRC Section 469(c)(3)(A)?
2. What is my current and projected basis and at-risk amount under IRC Section 465 for the specific capital contribution under consideration?
3. How would a capital contribution made in connection with a specific liquidity event interact with the Section 57(a)(2) alternative minimum tax preference calculation for that year?
4. Does the timing of the proposed capital contribution satisfy the economic performance requirement under Section 461(h), including the 90-day drilling exception if applicable?
5. How does the Section 461(l) excess business loss threshold for the relevant filing status affect the amount of loss that can be used in the year of the liquidity event versus carried forward?
6. Does my partnership agreement or firm policy require disclosure or approval of outside business interests of this type?
7. How will percentage depletion under Sections 611 and 613A be treated once a specific well begins producing, and how should that be modeled separately from the initial intangible drilling cost deduction?
8. What self-employment tax considerations, if any, apply to my specific holding structure, consistent with the analysis in Methvin v. Commissioner?

Closing Perspective

> Business attorneys spend their professional lives helping clients structure transactions, entities, and liquidity events with tax consequences fully in view. Their own compensation — concentrated in K-1 distributive shares, success fees, and partnership transitions — often receives less structured attention, in part because so few statutory tools are built for that specific income pattern.

The working interest exception under IRC Section 469(c)(3), connected procedurally to the intangible drilling cost election under Section 263(c), is one of the few provisions in the tax code that offsets active income without requiring a minimum-hours test — a detail that matters directly for a profession built on billable time. Understanding how the statute works, how the entity-structure requirement operates, and how the related at-risk, AMT, timing, and loss-limitation provisions interact is the necessary foundation before any business attorney — or the CPA and tax counsel advising them — can evaluate whether direct working interest participation fits a specific year's tax and liquidity picture.

Summit Ventures structures its entrepreneurial joint venture participation specifically to preserve these statutory elements, and encourages every prospective business participant to review the mechanics described here with their own qualified tax professional before proceeding.

Sources and References

[1] Cornell LII, 26 U.S.C. § 469(c)(3)(A) — working interest exception. [2] Cornell LII, 26 CFR 1.612-4 — IDC election and definition of operator. [3] IRC § 263(c) — intangible drilling and development costs. [4] 26 U.S.C. § 57(a)(2)(A) — excess IDC preference item, 65% net-income threshold. [5] 26 U.S.C. § 57(a)(2)(E) — independent producer election, 40% AMTI cap. [6] 26 U.S.C. § 465 — at-risk limitation rules. [7] 26 U.S.C. § 461(h) — economic performance requirement. [8] 26 U.S.C. § 461(l) — excess business loss limitation, 2026 thresholds. [9] 26 U.S.C. §§ 611 and 613A — percentage depletion for independent producers. [10] Methvin v. Commissioner, 10th Cir. 2016. [11] IRS IR-2025-111, 2026 retirement plan contribution limits. [12] IRS Rev. Proc. 2025-32, 2026 federal income tax brackets. [13] One Big Beautiful Bill Act of 2025. [14] U.S. Energy Information Administration, 2025–2026 crude oil production figures. [15] American Petroleum Institute, "Industry Explained," 2023. [16] Tax Reform Act of 1986. [17] U.S. Treasury Department, 1916 guidance and 1954 IRC codification.

Ready to Explore Direct Working Interest Participation?

Summit Ventures structures entrepreneurial joint venture participation specifically to preserve the statutory elements described in this white paper. Connect with our team to discuss whether direct working interest participation fits your specific tax and liquidity picture.

Connect With Summit Ventures