North Dakota Office of State Tax Commissioner

Guideline - Income Tax Withholding: Oil and Gas Royalty Payments

Ryan Rauschenberger,
Tax Commissioner

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Introduction

This guideline is for persons responsible for making royalty payments to royalty owners of oil or gas produced in North Dakota. It explains the requirements for withholding North Dakota income tax from North Dakota oil or gas royalty payments made to nonresident individuals and non-North Dakota domiciled business entities. This guideline reflects changes made by the 2015 North Dakota Legislature and applies to royalty payments made on or after January 1, 2016. For information applicable to payments made prior to January 1, 2016, contact the North Dakota Office of State Tax Commissioner. The income tax withholding on oil and gas royalties is administered in a similar manner as employers' withholding of income tax on wages.

In this guideline, information is provided on the following topics:

- Definitions of terms used in this guideline
- Income tax withholding requirement
- Exceptions to the withholding requirement
  - Exception for a small producing remitter
  - Exception for certain royalty owners
  - Exception for payment amount below statutory threshold
- Amount to withhold
- Registration requirement
- Reporting and payment requirements
  - Quarterly withholding return and payment of withheld tax
  - Annual return
  - Information returns for royalty owners
  - Reporting by a publicly traded partnership

Definitions of terms used in this guideline

Non-North Dakota domiciled business entity. A business entity with a commercial domicile located outside North Dakota. Commercial domicile is the principal place from which the trade or business is directed or managed. A business entity includes a partnership, corporation, and any person other than an individual.

Nonresident individual. An individual who is not a legal resident of North Dakota for income tax purposes for the entire year. This includes an individual who is a legal resident of a foreign country. Legal residence refers to an individual's place of permanent residence to which an individual always returns whenever absent from it. Absences attributable to employment, vacation, military service, attending college, etc., do not affect an individual's place of legal residence if the individual intends on returning to it when the activity is completed.

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North Dakota oil or gas royalty. A payment to a royalty owner that represents the royalty owner's share of receipts from the sale of oil or gas extracted from within the boundaries of North Dakota. The amount that is subject to North Dakota income tax withholding is the gross amount of the North Dakota oil or gas royalty reported in Box 2 of the federal or state-only Form 1099-MISC or 1042-S.

Person. An individual, estate, trust, partnership, corporation, limited liability company, and any other type of entity recognized under North Dakota law.

Remitter. A person that distributes a royalty payment to a royalty owner. A remitter may be the person that produces the oil or gas or the person that distributes the royalty on behalf of a producer. In all cases, the remitter is the person whose name and federal employer identification number (FEIN) are required to be entered in the payer boxes on the federal or state-only Form 1099-MISC or 1042-S.

Royalty owner. A person entitled to receive periodic royalty payments for a nonworking interest in the production of oil or gas, and the person to whom a remitter is required to issue a federal or state-only Form 1099-MISC or 1042-S to report the royalty payments. If a royalty owner is a single-member limited liability company (LLC) that is a disregarded entity for federal income tax purposes, the owner of the single-member LLC is considered to be the royalty owner, and the federal or state-only Form 1099-MISC or 1042-S must be issued in the name and taxpayer identification number (social security number or FEIN) of the LLC's owner. *(Note: If a remitter receives a federal Form W-9 on which it is indicated that the royalty owner is a single-member LLC that is disregarded, the name and taxpayer identification number on the Form W-9 should be that of the LLC's owner instead of the LLC itself.)*

State-only Form 1099-MISC or 1042-S. A federal Form 1099-MISC or 1042-S prepared on a pro forma basis for North Dakota income tax purposes for a royalty owner with North Dakota oil or gas royalty payments for whom a federal Form 1099-MISC or 1042-S is not required to be issued for federal income tax purposes. See "Information returns for royalty owners" later in this guideline for more information.

Income tax withholding requirement

A remitter is required to withhold North Dakota income tax from North Dakota oil or gas royalty payments made on or after January 1, 2014, to nonresident individuals and non-North Dakota domiciled business entities.

Determining residency or commercial domicile status of a royalty owner. A remitter needs to know the residency or commercial domicile status of a royalty owner to properly comply with this withholding requirement. If a remitter does not know the residency or commercial domicile status of a royalty owner, the remitter may use any reasonable means to determine the status. This may include reliance on the address to which a royalty payment is mailed or the address provided by the royalty owner on a federal Form W-9. In some cases, a remitter may need to contact the royalty owner to obtain the information.

Nonresident alien. This withholding requirement applies to an individual royalty owner who is a nonresident alien of the United States. It applies even if the royalty income is exempt from U.S. income tax because of an income tax treaty between the United States and a foreign country. Except where an income tax treaty between the United States and foreign country specifically exempts oil or gas royalty income from state taxation, income tax treaties between the United States and foreign countries are not recognized for North Dakota income tax purposes, and North Dakota oil or gas royalty income is subject to North Dakota income tax.

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Voluntary agreement to withhold. A remitter and a royalty owner other than a nonresident individual or non-North Dakota domiciled business entity may mutually agree to have North Dakota income tax withheld on a voluntary basis from the royalty owner's North Dakota oil or gas royalty payments. If North Dakota income tax is voluntarily withheld, the remitter must comply with the registration, reporting, and payment requirements explained in this guideline.

Accounting service provider. A remitter may arrange with a third-party accounting service to handle the withholding, reporting, and payment duties on behalf of the remitter. However, the remitter remains responsible for any failure to comply with any of the withholding requirements. See "Registration requirement" later in this guideline for more information.

Exceptions to the withholding requirement

This section of the guideline explains the three exceptions to the withholding requirement.

Exception 1: Exception for a small producing remitter

A remitter is exempt from the withholding requirement if the remitter is an oil or gas producer whose production in North Dakota for the preceding calendar year was less than 350,000 barrels of oil or 500 million cubic feet of gas. This exception does not apply if a remitter is not a producer.

Even though a remitter is not required to withhold tax because of this exception, the remitter is required to file an annual return (Form RWT-1096) to report the North Dakota oil or gas royalties paid to each nonresident individual and non-North Dakota domiciled business entity royalty owner. On the annual return, the remitter must also report the amount of the oil or gas production for the preceding calendar year to certify that the remitter qualifies for the small producing remitter exception. See "Annual return" under "Reporting and payment requirements" later in this guideline for more information.

Even though a remitter is exempt from the withholding requirement under this exception, the remitter is not prohibited from withholding income tax from the royalty payments made to royalty owners.

Measuring the production threshold. The volume of production used to determine whether the threshold is exceeded is the amount reported by a well operator to the North Dakota Industrial Commission, Oil and Gas Division, on Forms 5 and 5B for the preceding calendar year. If the production data reported to the Industrial Commission by the remitter includes production attributable to other producers, only use the production data for the remitter's respective interest in the production for purposes of the production threshold. If the remitter acquired or disposed of production interests during the calendar year, only use the production attributable to the time period in which the remitter had an interest in the production for purposes of the production threshold.

Exception 2: Exception for certain royalty owners

A remitter is not required to withhold North Dakota income tax from North Dakota oil or gas royalty payments made to any of the following entities:

- The United States or any of its agencies, or any state and its political subdivisions.
- A federally recognized Indian tribe with respect to on-reservation oil and gas production pursuant to a lease entered under the Mineral Leasing Act of 1938 [25 U.S.C. 396a – 396g].
- The United States as trustee for individual Indians.
- A publicly traded partnership, as defined in Internal Revenue Code § 7704, that is not treated as a corporation.
- An organization that is exempt from North Dakota income tax under N.D.C.C. § 57-38-09.
- The same person or entity as the remitter.

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Notification of exempt status by publicly traded partnership or tax-exempt organization. A publicly traded partnership or an organization exempt from North Dakota income tax must complete and provide Form RWT-EXM to each remitter and the Office of State Tax Commissioner to verify its exempt status. This form needs to be filed only one time; a new form does not have to be filed each year. If the entity receives North Dakota oil or gas royalty payments from more than one remitter, the entity should provide a copy of the Form RWT-EXM to each remitter. If an entity fails to meet the definition of a publicly traded partnership or loses its exempt status under N.D.C.C. § 57-38-09, the entity must complete a new Form RWT-EXM on which it indicates that it is no longer exempt from withholding and provide a copy to the remitter and the Office of State Tax Commissioner.

Year-end reporting by publicly traded partnership. For information on the year-end reporting requirement by certain publicly traded partnerships, see "Reporting by a publicly traded partnership" under "Reporting and payment requirements" later in this guideline.

Unrelated business taxable income of tax-exempt organization. This exception does not affect the taxation of an entity's unrelated business taxable income (UBTI), if any, under North Dakota income tax law.

Exception 3: Exception for payment amount below statutory threshold

Upon written request, the Office of State Tax Commissioner will allow a remitter to forego withholding North Dakota income tax from any North Dakota oil or gas royalty payment that is less than a statutory threshold amount, as explained below:

- For royalty payments made on a quarterly basis, no withholding is required from a payment that is less than $600.
- For royalty payments made on other than a quarterly basis—for example, monthly or semiannually—no withholding is required from a payment that, when annualized, is less than $1,000.
  - Example 1: If a remitter makes royalty payments on a monthly basis, no withholding is required if the amount of the payment is $83.33 or less. This is because $83.33, when annualized, equals $999.96 ($83.33 x 12 months), which is less than $1,000. Withholding would be required on a monthly payment that is more than $83.33.
  - Example 2: If a remitter makes royalty payments on a semiannual basis, no withholding is required if the amount of the payment is $499.99 or less. This is because $499.99, when annualized, equals $999.98 ($499.99 x 2 semiannual periods), which is less than $1,000. Withholding would be required on a semiannual payment that is $500 or more.

Making the written request. A remitter may request to use this exception by completing the applicable part of the *Application to Register for Royalty Withholding*, the registration form that all remitters must complete and file with the Office of State Tax Commissioner. If a remitter has already filed the registration form without requesting the use of this exception, the remitter may submit a letter to the Office of State Tax Commissioner to request the use of the exception under N.D.C.C. § 57-38-59.4(6). For more information, see "Registration requirement" later in this guideline.

Amount to withhold

The amount to withhold is determined by multiplying the gross amount of the North Dakota oil or gas royalty by the highest marginal individual income tax rate reduced by 0.75%. For calendar years 2016 and after, the highest individual income tax rate is 2.90%, resulting in a withholding tax rate of 2.15% (2.90% - 0.75%). This withholding tax rate applies to all types of royalty owners, regardless of whether the royalty owner is an individual, estate, trust, partnership, or other type of business entity. The rate is subject to change by the North Dakota Legislature, and this guideline will be updated as needed to reflect any change in the rate.

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Funds held in trust. North Dakota income tax withheld from royalty payments made to royalty owners is deemed to be held in trust by the remitter for the State of North Dakota. All amounts withheld must be submitted to the Office of State Tax Commissioner in the manner set out in this guideline, regardless of whether or not the amount was properly withheld.

Registration requirement

Every remitter must register with the Office of State Tax Commissioner by completing and filing the registration form *Application to Register for Royalty Withholding*, which is available on the Office of State Tax Commissioner's web site. A remitter must register even if any of the exceptions to the withholding requirement apply or the remitter does not withhold any tax for any reporting period. Every remitter is subject to certain reporting requirements regardless of whether or not the remitter is required to withhold any tax—see "Reporting and payment requirements" later in this guideline for more information.

Accounting service provider. A remitter that arranges with another party to handle the remitter's royalty withholding filing and payment duties must complete the appropriate part of the registration form to designate and identify the provider. The designation of the provider on the registration form will constitute the remitter's consent for the Office of State Tax Commissioner to communicate directly with the provider about the remitter's royalty withholding returns and payments. A remitter may revoke the provider designation and consent by completing and filing a new *Application to Register for Royalty Withholding* on which the remitter requests the revocation.

Request to forego withholding from a payment amount below the statutory threshold. As explained under "Exceptions to the withholding requirement," a remitter may submit a written request to forego withholding North Dakota income tax from a North Dakota oil or gas royalty payment that is less than the statutory threshold. A remitter may make this request by completing the appropriate part of the registration form.

Change in FEIN. If a remitter's FEIN is changed for any reason, or the quarterly or annual return will be filed under a different FEIN, the remitter must complete and file a new *Application to Register for Royalty Withholding* to register the change.

Cash deposit or bond or undertaking executed by surety company. If required by the Office of State Tax Commissioner, a remitter must either make a cash deposit or post a bond or undertaking executed by a surety company authorized to do business in North Dakota. The amount of the cash deposit, bond, or undertaking will be reasonably calculated to ensure the payment of the tax withheld by the remitter.

Closing an account. If a remitter will be permanently ceasing activity as a remitter or will no longer be making North Dakota oil or gas royalty payments, it must notify the Office of State Tax Commissioner. Upon notification, the Office of State Tax Commissioner will provide the information that the remitter will need to satisfy any remaining royalty withholding requirements and close the account.

Reporting and payment requirements

Quarterly withholding return and payment of withheld tax

Every remitter required to withhold North Dakota income tax must file Form RWT-941, *Royalty Withholding Return*, on a calendar year quarterly basis and pay the royalty withholding tax due with the return. The return may be filed electronically or on paper.

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Electronic filing. A remitter may register to electronically file Form RWT-941 using North Dakota's Withholding E-File program. The remitter registers for this program by completing the appropriate part of the *Application to Register for Royalty Withholding*. The Withholding E-File program allows a remitter to electronically submit the return information and pay any tax due through an ACH Credit electronic funds transfer transaction. (An ACH Debit electronic funds transfer is not available for royalty withholding purposes.) The remitter is responsible for any applicable bank fees. The ACH Credit transaction satisfies the return filing requirement, and no additional information is required to be submitted. A timely reminder to file will be sent to the e-mail address that the remitter provides at the time the remitter registers for withholding or electronic filing. Failure to receive a reminder does not relieve the remitter's obligation to timely file the return. For more information about using the Withholding E-File program, see the *Guideline: Income Tax Withholding E-File*. Although the guideline specifically refers to "employers," the procedures also apply to remitters for purposes of withholding from oil and gas royalties. However, the addenda record specified for royalty withholding (located on the Office of State Tax Commissioner's website) must be used instead of the addenda record for employer's wage withholding.

Paper filing. If a remitter filed a paper return for the preceding tax period, a preaddressed Form RWT-941 is mailed to the registered remitter prior to the end of the calendar quarter. If a registered remitter does not receive a preaddressed form, the remitter should contact the Office of State Tax Commissioner before the due date of the return. Blank forms are also available on the Office of State Tax Commissioner's web site. Failure to receive a form does not relieve the remitter's obligation to timely file the return.

Due dates. Form RWT-941 must be filed on or before the following due dates:

Calendar quarter	Due date
January, February, March	April 30
April, May, June	July 31
July, August, September	October 31
October, November, December	January 31

Payment of income tax withheld. The total amount of North Dakota income tax withheld during the quarter must be remitted with Form RWT-941. If filing electronically, payment is automatically made as part of the ACH Credit transaction. *(Note: Payment by ACH Debit electronic funds transfer is not available for royalty withholding purposes.)* If a paper return is filed, a check or money order must be submitted with Form RWT-941.

Monthly filing and payment option. In lieu of filing and paying on a quarterly basis, a remitter may elect to file Form RWT-941 and pay the tax due on a monthly basis. This option is available only if a remitter files and pays electronically. A remitter must contact the Office of State Tax Commissioner to arrange for monthly filing and payment. If this election is made and approved, a remitter must continue to file and pay on a monthly basis until it obtains permission to change.

Annual filing and payment option. In lieu of filing and paying on a quarterly basis, a remitter may elect to file Form RWT-941 and pay the tax due on an annual basis if all of the following conditions apply:

- The remitter had an obligation to file Form RWT-941 for all four quarters of the preceding calendar year.
- The remitter filed Form RWT-941 and paid the full amount of North Dakota income tax required to be withheld on or before the due date for all four quarters of the preceding calendar year.
- The total North Dakota income tax withheld by the remitter during the preceding calendar year was less than $500.

A remitter must contact the Office of State Tax Commissioner to arrange for annual filing and payment.

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Annual return

All remitters must file Form RWT-1096, *Royalty Withholding Annual Return and Transmittal*. The due date for the annual return for calendar year 2015 is February 29, 2016. The due date for calendar years after 2015 is January 31 following the close of the calendar year. The annual return is used to report the total North Dakota oil and gas royalties paid and the total North Dakota income tax withheld from the payments during the calendar year and to transmit copies of the federal and state-only Form 1099-MISC and 1042-S forms issued to the royalty owners. For more information on issuing year-end information returns to the royalty owners, see "Information returns for royalty owners" later in this guideline.

The annual return is also used to report:

- A change in tax on one (or more) of the four quarterly Form RWT-941 returns filed for the same calendar year to which the Form RWT-1096 applies.
- A reissuance of a federal Form 1099-MISC or 1042-S for a prior tax year to reflect a corrected federal Form W-9 received from a royalty owner. A copy of the corrected federal Form 1099-MISC or 1042-S must be submitted with Form RWT-1096.

Small producing remitter. Even though a remitter is a small producing remitter that is exempt from the North Dakota oil or gas royalty withholding requirement, the remitter must file Form RWT-1096 to report the North Dakota oil or gas royalties paid to each nonresident individual and non-North Dakota domiciled business entity royalty owner. The remitter must also report the amount of the oil or gas production for the preceding calendar year to certify that the remitter qualifies for the small producing remitter exception.

Paper filing only. Form RWT-1096 may not be filed electronically; it must be filed on paper. A preaddressed Form RWT-1096 is mailed to every registered remitter in early January following the end of the calendar year. A remitter may also obtain a copy of the form on the Office of State Tax Commissioner's website at www.nd.gov/tax.

Information returns for royalty owners

Regardless of whether or not North Dakota income tax is withheld from any royalty payment, every remitter must file with the Office of State Tax Commissioner a copy of all federal Form 1099-MISC and 1042-S forms reporting North Dakota oil or gas royalty payments. If a remitter is not required to file a federal Form 1099-MISC or 1042-S for a royalty owner for federal income tax purposes—for example, the royalty owner is a corporation—the remitter must prepare and file a copy of a state-only Form 1099-MISC or 1042-S. The state-only Form 1099-MISC or 1042-S must show the same information that would have been reported on a federal Form 1099-MISC or 1042-S had one been required to be filed for federal income tax purposes.

- **Electronic filing.** If a remitter is required to electronically file federal Forms 1099-MISC and 1042-S for federal income tax purposes and the number of copies required to be filed with North Dakota is 250 or more, the remitter must electronically file them for North Dakota income tax purposes. Even if not required, electronic filing is recommended. If a remitter electronically files the forms, no paper copies should be filed with Form RWT-1096; however, the remitter must indicate the date of the electronic transmission on Form RWT-1096. See the *Guideline: Income Tax Withholding Information Returns* for more information on how to electronically file the forms.
- **Paper filing.** Unless a remitter is required to electronically file the copies of federal Forms 1099-MISC and 1042-S, a remitter may file paper copies of the forms. The paper copies must be submitted with Form RWT-1096 when it is filed.

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If a remitter transmits federal Form 1099-MISC information to the IRS under the Combined Federal/State Program admininstered by the IRS, it must separately submit any federal Form 1099-MISC containing North Dakota income tax withheld with the Form RWT-1096.

Other reportable payments. If any other type of North Dakota reportable payment, such as rental income or non-employee compensation, is reported along with North Dakota oil or gas royalties on the same federal Form 1099-MISC, the submission of the one federal Form 1099-MISC as part of the Form RWT-1096 filing (whether in paper or electronic form) satisfies all of the North Dakota reporting requirements. A separate submission of the same federal Form 1099-MISC under the information return requirements for non-royalty payments does not have to be made for North Dakota tax purposes.

Reporting to royalty owners. On or before January 31 following the end of the calendar year, a remitter must provide each royalty owner a copy of the federal or state-only Form 1099-MISC or 1042-S showing the total North Dakota oil or gas royalties paid and the total North Dakota income tax withheld from them for that calendar year. The form issued to each royalty owner must have the correct taxpayer identification number (social security number or FEIN) as reported to the remitter on federal Form W-9, and North Dakota must be identified as the state in Box 17 of Form 1099-MISC or Box 17c of Form 1042-S.

Reporting by a publicly traded partnership

A royalty owner that is a publicly traded partnership must electronically transmit a copy of all of its federal Schedule K-1 forms to the Office of State Tax Commissioner if (1) the publicly traded partnership's North Dakota oil or gas royalty payments are exempt from North Dakota income tax withholding and (2) the publicly traded partnership electronically files its federal Schedule K-1 forms with the Internal Revenue Service. Contact the Office of State Tax Commissioner for instructions on how to submit this information.

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Fax: 701.328.0332
Email: taxregistration@nd.gov