

Quadrant II-Notes

Paper Code : COD 121

Module : Royalty Accounts- Introduction & Important Terms

Introduction:

Royalty is an consideration received by business enterprises or individuals for allowing to use their inventions/ creations by a third party. Typically, royalty is considered to be synonymous with rent; but it varies completely. Where rent is paid for using tangible assets like building, machinery etc., and royalty is paid for using intangible assets or availing special rights such as patents, copyright, mines etc. secondly, the amount of rent paid by the user is fixed. Whereas royalty paid by the user to the owner varies based on the quantity of goods produced or sold.

Meaning of Royalty:

Royalty is a periodical payment made by the user of the asset to the owner or the creator of such an asset for its use. In other words, it is a periodic payment for the use of certain property or right like mine, patent, book, artistic work etc.to its owner. This right may be of any of the following types:

1. Right to extract minerals from mines.
2. Right to use certain patents for manufacturing any article; and
3. Right to publish book and sell them.

Parties involved- Lessor/ landlord/ owner/ authors and Lessee/user/ publishers/Licencees

Types of Royalty:

There are following types of royalties in accounting. These include:

1. Mining Royalty- In this type of royalty, the lessee pays royalty to the lessor based on the no of units (output)produced.

2. Patent Royalty – It is royalty paid by the lessee to the lessor based on the number of items produced.

3. Copyrights -Copyright provides the right to the author or owner of assets like book, artwork, music composition etc. to claim royalty from the publisher and publishers pay copyright royalty to the author based on sales made by the publishers.

Important Terms :

1. Minimum Rent/ Dead Rent / Rock Rent/ Fixed Rent

Minimum Rent is a fixed rent or guaranteed minimum amount received by the lessor from the lessee for the benefit derived from the use of certain property or right. It is fixed at the time when the lessor enters into an agreement with the lessee.

This term is included in the contract in the interest of the lessor / landlord as it assures minimum rent in cases of lower sales or output. Therefore, the lessee pays minimum rent or the actual royalty amount, whichever is higher.

For example , say output produced by Mine X is 3000 tons. Royalty to be paid is Rs. 100 per ton and minimum rent in the contract is Rs. 5,00,000.

Solution:

Minimum Rent = Rs. 5,00,000 and Actual Royalty = Rs. 3,00,000

Since the actual royalty amount is less than the minimum rent, lessee is required to pay lessor minimum rent of Rs. 500,000.

Alternatively, output produced is 6000 tons.

Minimum Rent = Rs. 5,00,000 and Actual Royalty = Rs. 6,00,000

Since the actual royalty amount is more than the minimum rent ,

lessee is required to pay lessor Rs. 600,000.

2. Short Workings or Redeemable Dead Rent

Short Workings is nothing but the amount by which the minimum rent is more than the actual royalty. In other words, short workings is the difference between minimum rent and actual royalty. It is referred as deficiency .

In the above example, Minimum Rent = Rs. 5,00,000 - Actual Royalty = Rs. 3,00,000

Therefore, Shortworkings = Rs. 2,00,000.

3. Excess Working

Excess Working is nothing but the amount by which Actual Royalty is more than the minimum rent. It is referred as surplus. In the above example, When output is 6000 tons. Excess working comes out be Rs. 1 ,00,000 (6,00,000- 5,00,000)

4. Recoupment of Short Workings

In the royalty agreement under Royalty Accounting there is a provision. This provision allows lessee to carry forward of short workings in order to adjust the same in future.

A process of adjusting Short Workings against the excess royalty amount is known as recoupment of Short Workings. It is a right getting back from the lessor, excess payment made by the lessee in the earlier years.

The right of recoupment may be either fixed or fluctuating/ Floating . Fixed Right: when the lessee can recoup Shortworkings within certain period from the date of lease , it is termed as fixed right.

Fluctuating /Floating Right of recoupment of short working is available in any year when short working year arises.