

## **Royalty Accounting**

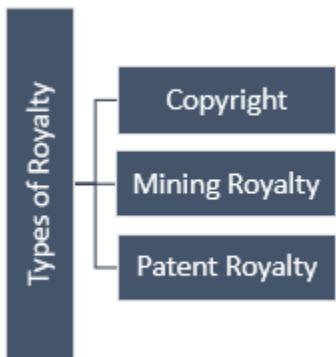
Royalty is payable by a user to the owner of the property or something on which an owner has some special rights. A royalty agreement is prepared between the owner and the user of such property or rights. If payment is made to purchase the right or property that will be treated as capital expenditure instead of a Royalty.

Payment made by the lessee on account of a royalty is normal business expenditure and will be debited to the Royalty account. It is a nominal account and at the end of the accounting year, balance of Royalty account need to be transferred to the normal Trading and Profit & Loss account. Royalty, based on the production or output, will strictly go to the Manufacturing or Production account. In case, where the Royalty is payable on sale basis, it will be part of the selling expenses.

### **Types of Royalties**

There are following types of Royalties –

- **Copyright** – Copyright provides a legal right to the author (of his book/s), the photographer (on his photographs), or any such kind of intellectual works. Copyright royalty is payable by the publisher (lessee) of a book to the author (lessor) of that book or to the photographer, based on the sale made by the publisher.
- **Mining Royalty** – Lessee of a mine or quarry pays royalty to lessor of the mine or quarry, which is generally based on the output basis.



- **Patent Royalty** – Patent royalty is paid by the lessee to lessor on the basis of output or production of the respective goods.

### **Important Terms**

Following are the important terms, which are used in Royalty agreements –

#### **Royalty**

A periodic payment, which may be based on a sale or output is called Royalty. Royalty is payable by the lessee of a mine to the lessor, by publisher of the book to the author of the book, by the manufacturer to the patentee, etc.

## **Landlord**

Landlords are the persons who have the legal rights on mine or quarry or patent right or copybook rights.

## **Tenet**

An Author or publisher; lessee or patentor who takes out rights (usually commercial or personal rights) from the owner on lease against the consideration is called tenet..

## **Minimum Rent**

According to the lease agreement, minimum rent, fixed rent, or dead rent is a type of guarantee made by the lessee to the lessor, in case of shortage of output or production or sale. It means, lessor will receive a minimum fix rent irrespective of the reason/s of the shortage of production.

Payment of royalty will be minimum rent or actual royalty, whichever is higher.

## **Shortworkings**

**Difference** of minimum rent and actual royalty is known as shortworkings where payment of Royalty is payable on the basis of minimum rent due to shortage in the production or sale.

## **Ground Rent**

The rent, paid to the landlord for the use of land or surface on the yearly or half yearly basis is known as **Ground Rent** or **Surface Rent**.

## **Right of Recouping**

It may contain in the royalty agreement that excess of minimum rent paid over the actual royalty (i.e. shortworkings), may be recoverable in the subsequent years. So, when the royalty is in excess of the minimum rent is called the right of recoupment (of shortworkings).

Right of recoupment will be decided for the fixed period or for the floating period. When the right of recoupment is fixed for the certain starting years from the date of royalty agreement, it is said to be fixed or restricted. On the other hand, when the lessee is eligible to recoup the shortworkings in next 2 or 3 years from the year of its commencement, it is said to be floating.

Shortworking will be shown on the asset side of Balance sheet up to allowable year of recouping after that it will be transferred to profit & loss account (after expiry of allowable period).