

TOPIC: IMPORTANT TERMS OF ROYALTY

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Meaning of Royalty

Royalty refers to the payment that is made to the owner of an asset or property for usage. Royalties enable another individual, who is not the original creator of the property or asset, to use the property in exchange for a payment or other terms.

Royalty is the sum payable by the lessee to the lessor for the use of rights vested in the lessor. It is a periodic payment. Royalty is generally paid on the basis of output or sale. It is paid for extraction of mines, for use of the patent, for use of technical know-how, to an author for sale of his books, etc.

Important Terms of Royalty

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

1. 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.

2. Landlord

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

3. 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..

4. 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.

5. 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.

6. 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**.

7. 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).

8. Lease Premium

An **Extra payment** in addition to royalty, if any, paid by lessee to lessor is called Lease premium and will be treated as capital expenditure and it will be written off on yearly basis through profit and loss account as per the suitable method.

9. TDS (Tax Deducted at source)

If there is an applicability of TDS (Tax deducted at source) as per Income Tax Act, lessee will make the payment to lessor after deducting TDS as per applicable rate and lessee is liable to deposit it to the credit of Central Government. Amount of royalty will be gross amount of royalty (inclusive of TDS), that will be charged to profit and loss account.

10. Stoppage of Work

Sometime, there may be stoppage of work due to conditions beyond control like strike, flood, etc. in this case, minimum rent is required to be revised as provided in the agreement.

Revision of the minimum rent will be –

- Reduction of minimum rent in the proportion of the stoppage of work;
- On the basis of fixed percentage; or
- By a fixed amount in the year of stoppage.

4. Sub Lease

Sometime, landlord or lessor allows lessee to sublet some part of the mine or land as a sub-lessee. In this case, lessee will become lessor for sub lessee and lessee for main landlord.

In such a case, as Lessee, he will maintain the following books of accounts –

As a Lessee

As a Sub Lessor

- Landlord accountAccount
- Minimum Rent Account
- Royalty Account
- Shortworkings Recoupable Accounts
- Royalties receivable Receivable accountAccount
- Sub lessee Lessee accountAccount
- Shortworkings allowable Allowable Account

Recoupment of Short-workings

The right of Recoupment means the right given to the lessee by the lessor to carry-forward and set-off the short-workings from the surplus of royalties over the Minimum Rent. It can be of two types:

1. Fixed Right of Recoupment:

When the lessor allows the lessee to adjust the short-workings only for a fixed period of time, it is known as Fixed Right of Recoupment.

2. Floating Right of Recoupment:

When the lessor allows the lessee to adjust the short-working of any year in the next two or three years, it is known as the Floating Right of Recoupment.

Minimum Rent or Fixed Rent

It is the amount that has to be paid by the lessee to the lessor whether or not he has derived benefit from the asset. Hence, it is also called Dead Rent or Rock Rent. Minimum rent can be a fixed sum for every year or may change every year as per the terms of the agreement.

- When the actual royalty for a year **is less than** the minimum rent, the lessee will pay the minimum rent to the lessor.
- When the actual royalty for a year **is more than** the minimum rent, the lessee will pay the actual royalty to the lessor.