

## REVOLUTION IN CIVIL LAW 2014: PART 5

### REAL ESTATE AND THE ASSOCIATED RIGHTS IN REM



As of January 1, 2014, rights in rem will be fundamentally regulated by the New Civil Code (“NCC”). The NCC introduces a number of changes in the area of real estate law, the largest of which pertains to the in rem nature of buildings.

#### 1. A Structure as part of a plot of land

##### 1.1 A structure will now be considered part of the plot of land on which it stands.

The current legislation allows for a structure and the plot of land it is built on to have different owners. The most important change in the NCC with regard to rights in rem is that a plot of land now includes the space above and below the surface, any structures built on the plot (with the exception of temporary structures), machinery and other equipment attached to the plot and vegetation growing on the plot. Unless an underground construction is treated as independent real property (see below), it will also form part of the plot, even if a small part of it extends below another plot. For practical reasons the NCC does not expressly consider utility lines and connections to be part of a plot.

On the basis of temporary provisions of the NCC, **most constructions will cease to be real property (independent objects) and will become part of a plot on which they are built** as of the effective date of the NCC, i.e. **January 1, 2014**.

1.2 However, a **structure will not merge with the plot in situations where the owner of the structure is not the owner (or equal co-owner) of the plot** on which the structure is built. In order to ensure that these structures also merge with the plot on which they are built in the future, **the NCC introduces a mutual right of first refusal**. It will not be possible to limit or eliminate this right by contract; it will continue in force until the structure merges with the plot. Transfers of real estate with divided ownership of the building and plot on which it is built will take longer and be more difficult to plan. The structure will also not merge with the plot in cases where it is precluded by the nature of the right in rem encumbering either the structure or the plot, for as long as such different rights in rem continue in force, e.g. a lien only on a building.

1.3 In order to protect the good faith of third parties **a structure will merge with a plot in situations where ownership rights to the plot are transferred to a third party, who believes in good faith that the structure is part of the plot** (this applies primarily to smaller structures not registered in the Land Registry). The original owner of the structure will have the right to request compensation in the amount of the value of the structure from the original owner of the plot.

## 2. New definition of real property

- 2.1 According to current legislation, real property must have material form. The NCC changes that. **The NCC will expand the definition of real property to include certain rights.** Under the NCC, real property will mean: a) plots of land (including the structures that are merged with them), b) rights in rem to the plots of land (easements, liens, rights of retention), c) underground structures with an independent special-purpose designation (e.g. wells, underground garages or wine cellars, including a metro system), d) rights in rem to the previously stated underground structures, e) rights declared by law to be real property (newly introduced surface rights), f) objects declared by legal regulation not to be part of the plot, when such object also cannot be transported without violating its nature (e.g. caves, coal deposits), g) units (residential or non-residential premises, as spatially distinct sections of a building with shares in the common areas of the relevant real property, and sets of such residential or non-residential premises), h) structures that have not merged with a plot. The new definition of real property comes into play, for instance, when handling communal property, as well as with companies where consent is required for property transfers.
- 2.2 Even though in most cases structures will become part of the plots they are built on as of January 1, 2014, for **accounting and tax purposes structures and plots will continue to be listed separately.** It will continue to be **possible to amortise structures only.** For the purposes of VAT, real property, including e.g. surface rights, will be included under the definition of "goods." The **VAT scheme currently applied to structures** will be applied to **sales of plots with structures built on them.** This means that transfers of structures (including the plots on which they stand) will be subject to VAT up to five years after receiving their final occupancy permit (in Czech: kolaudace).

## 3. Surface rights

- 3.1 **The NCC introduces surface rights** as a special **transferrable right in rem** belonging to the builder (the person who has the building right) **to have a structure on or below a plot belonging to another owner.** Based on this right, the NCC **allows for dividing the fate of structure and plot** for up to 99 years. The structure itself is just part of the surface right, so the surface right will not expire automatically upon expiry of the structure. Surface rights will be of practical use primarily in cases where the owner of a plot does not want to transfer ownership rights and no other solution will resolve the problem (e.g. long-term rent or servise). It will be possible to use surface rights as a hedged item even before the structure itself is created.
- 3.2 It will not be possible to establish surface rights on a plot that is subject to a right that goes against the purpose of the structure. If the plot is encumbered with a lien,

**the consent of the lien creditor will be necessary** in order to encumber it with surface rights.

- 3.3 The builder will have **the same rights as the owner** with regard to the structure.
- 3.4 It will be possible to acquire surface rights by entry into the Land Registry on the basis of a contract, acquisitive prescription or decision of a government body.
- 3.5 It will be possible to establish surface rights **free of charge or for consideration** in the form of a lump sum or repeated payment (building payment, in Czech: stavební plat); the building payment can be automatically adjusted depending on inflation.
- 3.6 Surface rights will include, in particular, the option of **establishing a new structure** on a plot belonging to someone else, although it may also consist of authorisation to **take possession of an existing structure** (e.g. for the purposes of renovating or modernising it).
- 3.7 It will be possible to **transfer or encumber** surface rights (if the owner of the plot so stipulated, then the structure can only be encumbered with the owner's consent, although it will be possible to encumber the right even before the structure itself is built); by law surface rights will **transfer to a builder's heirs and other legal successors**.
- 3.8 Unless the contractual parties state otherwise in their entry into the Land Registry, a builder and owner of the plot will have a **mutual right of first refusal**.
- 3.9 Unless the parties agree otherwise, **after the expiry** of the period for which the surface rights were agreed, **the builder will have a claim against the owner to compensation for the structure** in the amount of one half of the value of the structure at the time of expiry of the surface rights.

#### 4. Easements

- 4.1 The NCC regulates easements in much more detail than the current civil code. **The NCC will divide easements into services and real easements. Services will be characterised by the passivity of the owner of the item**, who must suffer something to the benefit of someone else (e.g. drawing water from the owner's plot) or refrain from something (e.g. not build above a certain height on the owner's own plot), while **real easements will oblige the owner of the servient item to take some action** (e.g. pay an annuity or provide part of the harvest to the recipient). The NCC then divides services in the same way as at present, into real (the right is derived from ownership of the item) and personal (the owner of the right is specifically determined).
- 4.2 **A service will include everything necessary for exercising it. The NCC**

**dispositively and demonstratively regulates the most common services in practice** (e.g. services on utility lines, paths and roads, water rights, and personal servitudes including rights of use, residence and usufruct), although the parties can agree on other rights and obligations than those stipulated by the NCC, or agree on services not foreseen by the NCC, as the case may be. It will still be very important to agree on the contents of the service clearly and in detail.

4.3 Services will typically encumber real property, although it will **now** be possible to **encumber movable property as well**. For items not entered into a public list (typically movable property) the service will arise by contract. Otherwise the service will arise by entry into the Land Registry, acquisition in case of death, acquisitive prescription (although it will not be possible to prescribe servitudes to forest plots), by law or based on an official decision.

4.4 One change that will be beneficial in practice is that the **owner of the plot will be able to encumber it in favour of another plot belonging to the same owner**. This will have practical application in the sales of real property where the seller will be able to unambiguously adjust the material future conditions in advance (e.g. right of way and right to pass through the plot being sold, utility lines, permitted building). For this reason the NCC also expressly stipulates that the service does not expire upon merger of the ownership of the dominant and servient property.

4.5 It will be possible to establish a **real easement** on a property entered into a public list (typically real estate) that will **encumber the property so that the owner will be obliged** as a debtor **to take some action toward the owner of the easement**. The real easement can be used as a security instrument. **The owner of the easement will be able to request even the new owner of the property to provide unfulfilled obligations under a real easement or financial compensation for the same**. When acquiring property encumbered with a real easement, it will therefore be necessary to verify that the previous owner duly fulfilled the obligations arising from the easement. It will not be possible to prescribe a real easement. **It will only be possible to establish a real easement as temporary**; to establish it as not time-limited, the conditions under which the obliged party will be able to buy out the easement must be agreed at the time of establishing the real easement.

## 5. Expanded options in the area of pledges

5.1 It will now be **possible to establish a lien on an item whose ownership rights will arise in the future**. This innovation will definitely find application in financing real estate transactions. It will be possible to have the future lien entered into the land registry with the consent of the owner of the real estate. The lien will then be created when the lien creditor acquires the ownership rights.

5.2 **The NCC reduces forbidden arrangements in lien agreements. It will be**

**possible to arrange a negative pledge.** If this negative pledge is entered into the Land Registry, it will affect third parties, which will not be able to acquire (another) lien on the encumbered property. After the maturity of the secured debt, large entrepreneurs will even be able to agree among themselves that the lien creditor can monetize the pledge in any manner they choose or keep it for any price they choose.

- 5.3 Under the NCC, with regard to insured pledges, **if an insurance company is informed of the existence of a lien**, in the event of an insurance event **it will have to provide performance** under the insurance policy **directly to the lien creditor.**
- 5.4 While respecting certain forbidden provisions, the **parties will now be able to agree** in a pledge agreement **how the pledge should be monetised** after the maturity of the debt, if applicable. However, the creditor will always be obliged to sell the pledge for the usual price in the given place and time.
- 5.5 **The decisive moment for the order of liens** on a property, which is critical for satisfaction of any pledge, **will be the moment of submitting the proposal for entry** of the lien into the Land Registry. **However, the lien creditors will be able to agree to change the order** of their liens.
- 5.6 The NCC also introduces **the institute of releasing liens, corresponding to the German Eigentümergrundschuld.** If a lien expires, but the entry regarding the lien is not deleted from the Land Registry, the lien will be considered released and the owner of the item will be able to use it for up to ten years to secure another debt up to the amount of the original debt. It will also be possible to forbid the use of this institute in the Land Registry entry.
- 5.7 Another change introduced is the option of **substituting a lien**, which will find application in refinancing loans. Lien substitution can also be forbidden by entry into the Land Registry, with effect toward third parties.
- 5.8 **Liens created prior to January 1, 2014 will be subject to the current legislation**, but parties will **have the option of adopting by agreement** the rights and obligations arising from liens under the **NCC.**

## 6. Land Registry

- 6.1 In connection with passage of the NCC, a new Land Registry Act will also take effect in 2014. This will result in several major changes to the current system.
- 6.2 **After the transition year is over, the land registry will be governed by the material publicity principle, i.e. the protection of good faith.** As of 2015, the ten-year prescription timeframe will no longer be decisive for acquiring rights from non-owners. If the status entered into the land registry does not reflect the actual legal status, the recorded status will testify in favour of the person who acquired the right



in rem **for consideration in good faith** from the authorised person according to the status recorded in the registry. The actual owner will be able to seek enforcement of its rights in court, although with shortened legal timeframes. The information regarding the commenced court proceedings to determine ownership rights or other rights in rem will be indicated in the land registry in the form of **a note on the disputability of the entry** on the affected property. From a practical standpoint, due to the risk of falsification it would at a minimum be advisable in the future for each owner of a property to check the entry in the land registry at least once every three years.

- 6.3 The scope of properties recorded will also change. **Incomplete buildings or units will no longer be recorded.**
- 6.4 The method of registering rights in the land registry (by entry, record or note) will remain the same. **Entry**, however, will register not only the creation, as stipulated by current legislation, but **also the change, expiration, lapse and acknowledgement of the existence of rights in rem and now also other rights agreed as rights in rem, as well as lease and tenancy** (in contrast to lease, the new definition of tenancy will include use of an item as well as **use of its fruits** – such as tenancy of an agricultural plot or commercial establishment). **The above clearly indicates that the number of proceedings subject to fees will increase as compared to the current system.**
- 6.5 Changes will also occur how the actual entry proceedings for entering a right take place before the Land Registry Office. The Land Registry Office will be obliged to inform the owner of the property **as well as every person with a right to the property entered into the land registry** (e.g. a lien, easement, right of lease or tenancy) immediately upon receipt of the proposal; the owner of the property will then be able to receive such information **by mobile phone or email**, if the owner so requests, instead of by mail delivery. However, this mandatory notification will obviously prolong the proceedings; the law will now only stipulate a minimum time frame for performing the entry of 20 days from the date of notifying the affected entities of commencing the proceedings. For the owner's protection it is advisable to ensure that **the correct address is listed** with the registry, so that the owner actually receives the information.
- 6.6 Fewer counterparts must now be submitted; instead of submitting counterparts equal to the number of participants in the legal proceedings plus two, a single counterpart will now suffice. **The participants to the proceedings will thus not receive a counterpart of the agreement endorsed by the Land Registry Office**, but will have to request a copy, if needed, from the collection of deeds of the Land Registry Office.

## 7. Modifications pertaining to the real estate transfer tax

Without regard to the reform of civil law, please also note that the real estate transfer tax can be contractually assigned to the purchaser. The important thing is that the **entry of real estate into companies will always incur the real estate transfer tax as of 2014**; the exemption of at least five-year participation in the company is repealed.

We hope that you have found our brief overview useful. Please direct any questions to the contact address indicated below and we will be happy to answer them.

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