



Gide Loyrette Nouel

Real Property Investment Law in the Czech Republic



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TITLE**Full ownership***General*

Full ownership of real property is recognised under Czech law. Further, ownership rights of real property benefit from constitutional protection.¹ Expropriation shall only be permitted in exceptional cases when such action is in the public interest, in the manner stipulated by law and with provision of full, unconditional and immediate compensation.²

Under Czech law, construction is not a part of the land. It means that the owner of a land is not automatically the owner of a construction constructed on this land.

Acquisition

Any agreement relating to the transfer of real property must be concluded in writing.³ Ownership of real property is acquired upon its registration in the cadastre. This registration enters into force retroactively, as of the date of the registration application and makes the transfer of title binding on third parties. Ownership rights are proved by providing a land registry extract.

Limitations on acquisition⁴

As far as natural persons are concerned, real property may be acquired by Czech citizens and citizens of a European Union Member State who have been delivered a declaration of residence in the Czech Republic (i.e. who are temporary residents). However, citizens of the European Union may not acquire agricultural lands and forests. Other foreign natural persons (even if they hold a residence permit) cannot acquire real property in the Czech Republic, except in some limited cases such as inheritance.

Real property may be acquired freely by Czech legal entities (i.e. entities having their registered seat in the Czech Republic) and foreign legal entities having their enterprise or branch located in the Czech Republic and authorized to carry on a business activity (except for agricultural lands and forests). Other foreign legal entities may not acquire real property in the Czech Republic.

The acquisition of real property by EU nationals who are not resident in the Czech Republic, and by companies from EU Member States which are not established and which do not have their enterprise or branch in the Czech Republic is limited for a transitional period of five years, i.e. until 1st May 2009.

Protection of ownership by courts

In the Czech Republic courts recognise ownership of real property. As real property in the Czech Republic is still undergoing a process of privatisation, it is advisable to check whether there are any privatisation claims before the courts.

¹ Article 11 of the Charter of Fundamental Rights and Freedoms.

² New expropriation Act No. 184/2006, entered into force on 1st January 2007

³ Article 46 of the Czech Civil Code.

⁴ Foreign Exchange Act 1995 (Law No. 219/1995 Coll.).

INTERESTS IN REAL PROPERTY CAPABLE OF REGISTRATION

The interests and property-related rights capable of registration into the cadastre are ownership rights, easement rights, mortgages and pre-emption rights.

These interests can be granted either by a written agreement between the parties, by a will, by a court decision upon an inheritance settlement, by an administrative or court decision. These interests have to be registered into the cadastre. An interest, as a right which affects the property of real property (land, building, flat, non-residential premises) is transferable with the real property.

The purchaser acting in good faith which acquires the real property encumbered with a recorded interest has the same obligations towards the beneficiary of the interest as the initial owner. Therefore, the acquisition of real property requires a careful examination on the existence of interests.

DEVELOPMENT OF LAND

The new Building Act 2006 entered into effect from 1st January 2007.⁵ The Building Act 2006 changes organisation of cooperation between the various authorities relating to land planning, construction and other procedures regulated by the Act.

Land planning

Land planning is a competence reserved to local authorities. The Building Act 2006 provides that the government of the Czech Republic decides on the policy of land development. Every regional office prepares the principles of land development, which must be approved by a Ministry for Land Development and adopted by a regional council.

In accordance with the adopted policy and principles of land development, every municipality council adopts a land plan. In the case of Prague, each local municipality adopts its own land plan with regard to the master plan of Prague and other land development documents.

Difficulties are expected within the next months as the planning procedures are becoming more complex and time-consuming under the Building Act 2006.

Permits relating to construction

All matters relating to construction are dealt with by the Construction Office, which is a State authority. Two separate permits are required in order to start with the construction of building: a planning permit and a construction permit. For certain type of buildings, such as family houses, the Building Act 2006 allows combining these two permits into one administrative act.

Planning permit – decision on location of construction

A planning permit is a decision by which state construction authorities express their consent with the location of a new building. The future building must comply with overall land planning documents. A written application for the planning permit is filed with the relevant construction office.

⁵ Act no. 183/2006 Coll. dated 14th March 2006.

The application comprises the data on compliance of the application with the above mentioned land planning documentation, urban incorporation of the proposed construction and the assessment of its environmental effects. The owners of adjoining buildings or lands are also parties to such a procedure.

Decision on location of a construction is valid for two years; however it does not lose its validity if an application for a construction permit is filed during this period.

Construction permit

A construction permit is the resolution of a competent construction office (municipal authority) authorising a constructor with construction of a building which has been approved by the planning permit.

Written application for construction permit must contain sufficient documentation for analysis of the proposed construction and conform to the above planning permit. During the approval process several statements are required and issued, such as: statement of fire protection inspection; statement of distributors of water, gas, electricity, sewage; statement of neighbours and others. The time limit for the decision in a simple case is 30 days. The time limit may be extended to 60 days with complicated constructions. A relatively small fee is charged for the construction permit. If the application is incomplete or irregular, the construction authority will ask the application to be completed within a given time-limit. In case of negative decision, an appeal must be filed within 15 days after the delivery of such decision.

A construction permit authorises the construction and sets binding conditions for the construction. Construction works may commence as of the days of effectiveness of the construction permit. If construction has not started within two years following the issuance of the permit, it will expire unless extended by the construction authority.

Occupancy permit

A construction built in accordance with terms set by the construction permit may be operated and occupied only upon the approval of operation of the building – the occupancy permit. The same construction authority which issued the construction permit is entitled to approve such occupancy permit. An on-site inspection is necessary and will determine the compliance of the construction with the construction permit and other applicable regulation is examined.

LEASES

Leases are governed by general provisions of the Czech Civil Code.⁶ Specific provisions apply to leases of non-residential premises, flats, as well as forestry and agricultural land.

Leasing with an option to purchase

Leasing with an option to purchase is a contract regulated by the Czech Commercial Code.⁷ It is a written lease contract during which the landlord grants the tenant an option to purchase the real property.

⁶ Articles 663 and following.

⁷ Articles 489 and followings of the Czech Commercial Code (Act no. 513/1991 Coll., as amended).

Financial leases

Financial leases are not governed by any specific regulations in the Czech Republic. Although, they must comply with general rules of the Czech Civil Code and the Czech Commercial Code applicable to leases. However, Czech tax law provides for a specific regime for the taxation of financial leases.

Financial leasing

Financial leasing is a *sui generis* contract, not regulated in the Civil Code or Commercial Code. The applicable rules ensue from civil law, commercial law, banking law and tax law.

Financial leasing is a lease under the terms of which a leasing company (credit institution) acquires, pursuant to the request of a client, a real property in order to lease that real property to that client for a certain duration. The leased property is registered in the financial accounts of the beneficiary during the performance of the contract. The client pays for all the expenses incurred in the acquisition and lease transaction in exchange for the use and quiet enjoyment of the real property. At the end of the lease, the client has the option to acquire the real property or surrender it to the leasing company.

Operative leasing without option to purchase

Operative leasing is also a *sui generis* contract, close to the leasing with an option to purchase contract. The commercial and bookkeeping treatment of operative leasing is similar to the financial leasing. The main difference is that a tenant of an operative leasing agreement may not purchase the real property at the end of the lease period. The real property needs to be physically handed back to the landlord who owns the real property during the entire lease period.

COMMERCIAL LEASES

Specific statute

Commercial leases are governed by the Commercial Leases Act 1990⁸ and the applicable provisions of the Czech Civil Code. In 2005 the Commercial Leases Act 1990 was modified to broaden the contractual freedom of the parties.⁹

Commercial classification

Premises may only be rented as commercial premises if they have been classified as such by a decision (in Czech "*kolaudační rozhodnutí*") issued by the local building control office. The decision is an administrative decision authorising the use of the building or the premises for a specific purpose. Furthermore, only the activities stated in the decision of the building control office may be exercised on the premises. It is therefore important to check which activities are authorised in the decision for the premises before concluding the lease.

⁸ Commercial Leases Act 1990 (Law No. 116/1990 Coll. dated 23 April, 1990).

⁹ Act No. 360/2005 Coll.

Form

A commercial lease agreement must be concluded in writing and must contain the following mandatory elements¹⁰ to be valid:

- clearly defined parties and real property concerned;
- the subject matter and purpose of the lease;
- amount of the rent and services charges or methods of calculation;
- duration of the lease (definite or indefinite period); and
- the activity performed by the tenant in the leased premises.

All other provisions may be freely determined by the parties.

Duration

A commercial lease may be concluded for a definite (no maximum period) or an indefinite period of time.

Termination*Indefinite term*

Unless otherwise stated in the lease agreement, either party may terminate a commercial lease signed for an indefinite period without any particular grounds with three months notice. The lease may provide for a different period. The notice period runs from the first day of the month that follows the notice's delivery.

Definite term

A lease agreement signed for a definite term terminates upon the expiry of the agreed term. It may also be terminated before the end of the term with three months notice *inter alia* for the following grounds, unless otherwise stipulated by the parties in the contract:

Grounds available to the landlord

- use of the leased premises by the tenant is in violation of contractual provisions;
- default in payment of the rent or service charges of more than one month;
- serious disturbance of peace and good order by the tenant despite a written notification;
- sublease of the leased premises without the landlord's prior approval;
- modification of the tenant's activity in the leased premises without prior notification to the landlord.

Grounds available to the tenant

- loss of qualification which entitled the tenant to carry out the activity for which the non-residential premises were leased;
- the leased premises become unfit for the agreed purpose through no fault of the tenant;
- the landlord grossly breaches his duty to keep the leased premises in a good condition.

¹⁰ Article 3 of the Commercial Leases Act 1990 (as amended).

Right of renewal

If the tenant continues to use the leased premises after the end of the term and the landlord fails to file a court summons for the premises to be handed over within 30 days, the lease agreement is renewed on the same terms¹¹:

- for a one year term if the lease was initially concluded for one year or longer;
- for the initial term if the lease was initially concluded for less than one year.

No pre-emption right of a tenant

Czech law does not grant a tenant's any pre-emption rights over commercial leased premises.

Rent and rent cap

The rent is freely determined by the parties. Czech law does not set any rent caps.

Rent review

The parties may provide for rent indexation in a lease agreement for commercial premises. The consumer price index (in Czech "*Index spotřebitelských cen*") published by the Czech Statistical Office is often used for rent indexation. However, any other Czech or foreign index may be used. The chosen index need not relate to the subject matter of the contract or the parties' business sector.

Costs rechargeable to tenants

As a rule, all costs paid by the landlord are rechargeable to the tenant (including costs of repairs, real estate tax, etc.).

Usually, the landlord can not recharge services charges (electricity, water and gas) to the tenant at a higher amount than the sum actually paid by the landlord to the service providers

Improvements

Unless otherwise agreed, the tenant must surrender the leased premises in the same condition as he took them over, allowing for usual wear and tear.¹²

The tenant may carry out improvements and alterations to the leased premises with the landlord's consent. The tenant may obtain the reimbursement of costs related to improvements from the landlord only by agreement.¹³ If the landlord consented to the improvements but did not undertake to pay compensation for the costs, the tenant may obtain compensation for the increase of value of the leased premises at the end of the lease. This increase of value is determined by the parties (on the basis of the costs incurred by the tenant) or by an expert if they fail to agree.

Transfer

Transfer without the prior consent of the landlord is not permitted.

¹¹ Article 676 of the Czech Civil Code.

¹² Article 13 of the Commercial Leases Act 1990 (as amended).

¹³ Article 667 of the Czech Civil Code.

Sublease

A tenant may only sublease non-residential premises or their part for a definite period, in writing and with the landlord's consent. The rights and duties of the tenant also apply to the subtenant.

TAX**Transaction costs***Sale of real property*Transfer tax¹⁴

The sale of real property is generally subject to transfer tax.

Payment of transfer tax

Since 1st January 2004, a 3% transfer tax based on the purchase price (either agreed between the parties or upon an estimation by an expert whichever is higher) is due on the transfer for consideration of real property in the Czech Republic.

The transferor has the legal obligation to pay the tax, while the transferee acts as guarantor. The tax declaration must be filed and the tax settled by the end of the third month following the month during which the registration of the transferee's ownership title in the cadastre is carried out.

Exemptions

The sale of real property is exempt from transfer tax *inter alia* in the following cases:

- the asset is contributed to the share capital of a company by a shareholder. However, if the shareholder retains its share in the company for less than five years and the asset is not returned to him when he withdraws from the company, transfer tax is due; or
- the asset is transferred between two companies pursuant to a merger or de-merger; or
- the first transfer of a new building or a new flat.

*VAT*¹⁵

Czech law differently treats the transfer of land and buildings. The transfer of land is VAT exempt. Nevertheless, the transfer of undeveloped land for which a valid building permit was obtained is subject to VAT at a current rate of 19%. The transfer of buildings is subject to VAT if such transfer occurs within three years from their acquisition or from the decision of a building control office relating to the building. The rate of VAT is currently 19% for commercial buildings and 5% for residential premises. A transfer performed after this period is VAT exempt. VAT is due separately from transfer tax.

Taxation of capital gains¹⁶ realised by legal entities

Capital gains arising from the sale of land and buildings are taxed at the usual corporate income tax rates (24% in 2007). Capital losses arising from the sale of land are not tax deductible.

¹⁴ Inheritance Tax, Gift Tax and Real Estate Transfer Tax Act 1990 (Law No. 357/1992 Coll.).

¹⁵ VAT Act 2004 (Law No. 235/2004 Coll.).

¹⁶ Income Tax Act 1992 (Law No. 586/1992 Coll.).

Leases*VAT*

As a rule, leases of land, buildings, flats and non-residential premises are VAT exempt. However, a VAT payer may decide to apply VAT to the lease of non-residential real property to other VAT payers, for the purpose of carrying out their economic activities. Such VAT payer must notify the tax administration of his decision to apply VAT on a specific lease within 30 days of conclusion of the relevant lease agreement.

Corporate income tax

Rent constitutes revenue for the landlord and is tax deductible for the tenant. A special regime applies to improvements made by the tenant.

Financial leases*VAT*

Financial leases of buildings are VAT exempt, with the exception of financial lease agreements which are concluded within three years of the acquisition or classification of the building concerned.

Corporate income tax aspects

Lease payments under financial leases with subsequent purchase of a leased real property which may be depreciated are recognised as an expense, under the following conditions:

- the minimum lease period is eight years (applicable in the case of buildings only); and
- on the termination of the lease, the purchase price of the leased property does not exceed the net book value which the leased property would have had if depreciated by the straight line method; and
- on termination of the lease agreement, the tax payer shall include the purchased asset in his business assets.

No land revenue tax

Land revenue tax is not levied in the Czech Republic.

Real property tax¹⁷

Real property tax is due by the owner of the land, building or flat. The taxation basis and rates are different for land and buildings. However, its amount is not particularly significant in both cases.

Land

The basis of the land tax is:

- the official price of land for agricultural land (determined as a multiple of the surface area of the land and the average price per square meter of the land as established by ministerial decree);

¹⁷ Real Property Tax Act 1992 (Law No. 338/1992 Coll.).

- the surface area of the land for other types of land (the surface area of the land under a building is not included).

The taxation rate depends on the type of land and its location.

Buildings

The building tax is calculated from the floor area in square meters of the building. The taxation rate differs according to the number of floors, the nature and purpose of the building and its location.

Flats and non residential premises

The tax is calculated from the floor area in square meters of the flat or of the non residential premises. The taxation rate differs according to its location.

Exemptions

There are several exemptions to real property tax. There is an exemption for newly-constructed residential buildings or flats owned by individuals for a period of 15 years after the decision of the building control office provided it is used as the permanent main residence of the owner.¹⁸

Payment of the tax

A real property tax return must be filed at the latest on 31st January of each year. The tax is usually payable yearly in two equal instalments (at the latest on 31st May and 30th November).

LEGAL COSTS REGARDING REAL PROPERTY ACQUISITIONS

Notary fees

As a rule, the intervention of a notary public is not compulsory in a transaction concerning real property, except in some specific cases. When a notary public is used, the maximum rates of notary fees are proportional to the transaction's value and vary between 2% and 0.05% of the transaction's value.

Lawyers

There are no statutory restrictions on the fees of lawyers.

Land registry

The charge for registration into the cadastre is CZK 500 (approximately EUR 18) per application.¹⁹

Publication

There are no statutory publication requirements.

¹⁸ Article 9 of Real Property Tax Act 1992 (Law No. 338/1992 Coll.).

¹⁹ Administrative Expenses Act 2004 (Law No. 634/2004 Coll.).

SECURITY USED IN REAL PROPERTY FINANCINGS

The main securities used in real property financings are mortgages, rights of retention, assignment of right of ownership, pledges and guarantees.

Mortgages²⁰

A mortgage is created on the basis of either a written contract, a court decision upon an inheritance settlement, or on the basis of a court or administrative authority ruling. Mortgages on real property are created upon registration in the cadastre, unless a law provides otherwise. A mortgage created on the basis of a ruling of a court or administrative authority arises as of the day when the ruling enters into force.

The time required for the registration to be completed depends on the location of the real property. The procedure may take up to six months for real property in the centre of Prague. Outside of the centre of Prague, it normally does not last more than two months. The registration costs are CZK 500 (approximately EUR 18).²¹ The rank of the mortgage depends on the date and time of the application for registration with the cadastre. This rank cannot be altered by contractual agreement.

A mortgage over real property may be realised only upon application of the creditor either by public auction or by judicial sale.

Agreements on mortgages may be void if they stipulate in particular that:

- the mortgage debtor may not encumber real property or a flat or non-residential premises in his ownership with a subsequent mortgage in favour of another creditor;
- the creditor may claim satisfaction from the sale of specific real property subject to a mortgage in a manner other than that laid down by law.

Right of retention²²

Pursuant to Czech law, the right of retention is governed by specific rules when applied to leases.²³ This right can be used only to secure the payment of rent. It applies exclusively to movable assets.

Thus, the landlord may retain all movable assets located in the leased premises to secure the tenant's payment obligations. If the landlord exercises his right of retention, he may use a bailiff appointed by the competent tribunal. Each bailiff visit has a charge of CZK 500 (approximately EUR 18).²⁴

Assignment of a right of ownership²⁵

Under this mechanism, the ownership of the asset is transferred from the debtor to the creditor who retains it until the complete payment of the debt. Once the debtor has discharged his debts in full, he recovers the ownership. In case of default, the ownership remains in the creditor's hands. Assignment agreements must be in writing. There are no particular costs except for the cadastre registration expenses of CZK 500 (approximately EUR 18). Although this mechanism avoids all administrative inconveniences, the tax consequences of the operation make it prohibitive.

²⁰ Articles 152 and following of the Czech Civil Code.

²¹ Administrative Expenses Act 2004 (Law No. 634/2004 Coll.).

²² Articles 175 and following of the Czech Civil Code.

²³ Articles 672 and following of the Czech Civil Code.

²⁴ Judicial Taxes Act 1991 (Law No. 549/1991 Coll.).

²⁵ Article 553 of the Czech Civil Code.

Bank accounts

The pledge usually applies to the debtor's deposit account. Banking expenses, formalities as well as the type of security used vary from bank to bank.

Additional security

Pledges over shares

Czech law provides for different formalities and costs depending on the type of company limited liability company (in Czech "*společnost s ručením omezeným*") or joint stock company (in Czech "*akciová společnost*").

Limited liability company

For the pledge of a "business share" (in Czech "*obchodní podíl*"), the share pledge agreement must be made in writing. The articles of association may require the approval of the company's general meeting. The pledge is created upon registration in the commercial register.²⁶ The registration costs amount to CZK 1,000 (approximately EUR 36)²⁷.

Joint stock company

The formalities applicable to the pledge of "shares in a certificated form" (in Czech "*listinné cenné papíry*") and "shares in a book-entry form" (in Czech "*zaknihované cenné papíry*") are different.²⁸

The pledge of "shares in a certificated form" is completed upon endorsement. No particular costs are involved.

The pledge of "shares in a book-entry form" is completed upon registration with the Prague Security Centre (in Czech "*Středisko cenných papírů*" (the "SCP")). The SCP registers a contractual pledge on the basis of an application made by a pledgee, a pledgor or a duly authorized third person. The request must be accompanied by the original or by an officially authenticated copy of the share pledge agreement. The price charged by the SCP does not exceed CZK 1,000 (approximately EUR 36).²⁹

Insurance policy proceeds

Insurance policy proceeds may also be the object of a pledge. In such a case, the pledgee and the pledgor must inform the insurer that the insurance policy proceeds may be paid directly to the pledgee.

Guarantees

Corporate guarantees are governed by the Czech Civil Code³⁰ or by the Czech Commercial Code³¹, while specific provisions of the Czech Commercial Code apply to bank guarantees³².



²⁶ Article 117 (a) of the Czech Commercial Code.

²⁷ See note no. 20 above.

²⁸ Article 39 and following of Act No. 591/1992 Coll. and article 154 and following of the Czech Civil Code.

²⁹ In accordance with the Price list of SCP.

³⁰ Articles 546 and following of the Czech Civil Code.

³¹ Articles 303 and following of the Czech Commercial Code.

³² Articles 313 and following of the Czech Commercial Code.

About the Law Firm

Gide Loyrette Nouel is an international law firm that has been advising real estate investors since 1920. Gide Loyrette Nouel has been present in Central and Eastern Europe since 1991.

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