LAW

In previous editions of Trend Report, we provided a summary of the most important institutes of Act no. 89/2012 Coll. of the Civil Code, as amended ("Civil Code"), and their impact on real estate practice.

Previous editions of Trend Report also show that the real estate market perceives the shortcomings of the re-codification of private law. These particularly include the ambiguities of the Civil Code, which affect the legal certainty of parties. Given that it's been three years since the Civil Code came into force, the case law of the Supreme Court is slowly beginning to form, which can help remove uncertainties associated with the adoption of the Civil Code.[1]

In the first part of this chapter, we will therefore focus on the year-on-year comparison of the development of the Supreme Court's case law, which may affect real estate transactions and the real estate market as such, as well as certain institutes that are important for real estate practice, which remain the subject of discussions (temporary building).

In the second part, we focused on the first amendment to the Civil Code, the result of which the pre-emption rights of co-owners of immovable property will be restored.

SETTLEMENT OF BUILDINGS ON THIRD PARTY LAND

Practice has been assimilated with the fact that from January 1, 2014, buildings became part of the land, provided that the same person had ownership rights to the building and the land. Buildings that were in the ownership of a person other than the landowner when the Civil Code entered into force did not become part of the land.[2] For this case, the Civil Code anchored the mutual statutory pre-emption right of the owner of the building and the land.

If the builder builds on third party land with the Civil Code in force, without having any legal title, this building shall accrue to the landowner,[3] who shall compensate the person who built the building in good faith for the reasonably incurred costs.[4] Other methods of settlement vary depending on whether the builder was in good faith or not. Upon an application by the landowner, the court may decide to remove the unauthorized building, but it may also order the land into the ownership of the builder for compensation, upon an application by either party. The builder may then demand that the landowner transfer the land to him for the usual price. The right to demand the purchase of the land by the builder is also retained in favor of the landowner.[5, 6]

The situation is more complicated if there is an unauthorized building on third party land that was built before January 1, 2014. With regard to the transitional provisions of the Civil Code, the building does not become part of the land. The question remains how such a building should be settled.[7] The Civil Code offers no guidance in this respect.

Under legislation in force until December 31, 2013, it was true that if someone builds an unauthorized building on third party land, the landowner could seek the removal of the building at the expense of the person who built it.[8] Under existing case law, the settlement of a building located on third party land took place in accordance with the legislation in effect at the time of the court's decision on the settlement. Accordingly, the settlement of unauthorized construction after January 1, 2014 should take place in accordance with the Civil Code.[9]

In the course of 2016, the Supreme Court had the opportunity to rule on the application of the Civil Code to legal relations arising from unauthorized construction on third party land before January 1, 2014. The Supreme Court ruled in the sense that the amendment to the Civil Code is not applicable to the settlement of these buildings, because the Civil Code is based on an opposite approach to the settlement of unauthorized buildings than the approach enshrined in transitional provisions. It stated that buildings built by a builder who is not the owner of the land before January 1, 2014, do not become part of the land.

The settlement of unauthorized buildings built before January 1, 2014 will therefore continue to be performed under Act no. 40/1964 Coll., Civil Code, whereas the removal of the building will continue to be the primary settlement.

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[1] For now, this case law is primarily associated with the application of transitional provisions of the Civil Code.

[2] This principle also applies to buildings that (i) are co-owned and the landowners are only some of the co-owners, or (ii) buildings that are to be built on third party land on the basis of substantive law incurred by the builder before the Civil Code entered into force, or pursuant to a contract concluded before the effective date of the Civil Code. Therefore, in our opinion, buildings located on third party land pursuant to a lease agreement concluded before January 1, 2014 did not become part of the land.

[3] In accordance with § 1084 of the Civil Code, a building built on third party land "falls into" the possession of the landowner. The term "falls into" was chosen with regard to the fact that such a building may be temporary, which is an independent building according to the Civil Code, and therefore does not become part of the land.

[4] In the case of a builder that was not in good faith during the construction, he is entitled to compensation for the actual increase in the value of the land after the construction,

[5] The nature of unauthorized construction is associated with the absence of a title at the time of its construction (judgment of the Supreme Court, File no. 22 Cdo 604/2013). If the building is built on third party land without a proper legal title, but this shortcoming is later remedied (the builder and landowner conclude a contract under which the builder accrues the factual or contractual right to build on the land), it will no longer be unauthorized construction (judgment of the Supreme Court, File no. 22 Cdo 1627/99).

[6] Assuming that he knew about the construction and did not cancel it without undue delay.

[7] There is also the question of whether the owner of the building has a legal pre-emptive right to the land on which the building is located.

[8] The court did not accede to remove the building unless it was purposeful. In this case, if the landowner agreed, the court could place the building in the landowner's ownership for compensation. Another way of settling the rights of the builder and landowner included granting an easement for compensation.

[9] For example, decision of the Supreme Court, File no. 22 Cdo 3122/2009.

The question remains how buildings rightly built on third party land before January 1, 2014 under a temporary title (e.g. lease) will be settled, the effect of which will expire under the Civil Code.

ACQUISITION FROM A NON-OWNER

In previous editions of Trend Report, we already addressed the issue of the acquisition of property from a non-owner based on the protection of the acquirer's good faith under the Civil Code. Given that the principle of acquisition from a non-owner based on good faith is only applied to transfers executed after January 1, 2015, we believe that in the context of real estate transactions, the possibility of acquiring ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner in the event of transfers made before January 1, 2014 (or 2015) will continue to be a current issue.

This issue has been questionable between the Constitutional Court and the Supreme Court for a long time. While the Constitutional Court subscribed to the conclusion that even though the law did not revise the possibility of acquiring ownership rights to real estate from a non-owner, it is possible for a purchaser to acquire ownership rights this way in good faith.[10]

In contrast, the Supreme Court argued that with regard to the principle that no one can transfer more rights than he has himself, it is not possible to acquire ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner in good faith with nothing else, but only if the ten-year prescriptive period also expires. In this case, a prescription of ownership rights occurs. The Supreme Court initially persisted in its argument, even after the Civil Code entered into force.

The turning point came in the ruling of the Supreme Court, File no. 31 Cdo 353/2016, in which the Grand Chamber concluded for the first time that according to legislation in effect until December 31, 2014, it was possible to acquire ownership rights to real estate registered in the Cadastre of Real Estate from a non-owner based on the good faith of the acquirer in the registry in the Cadastre of Real Estate.[11]

Unlike the Civil Code amendments, no restrictions similar to those in the Civil Code arise from the case law of the Constitutional Court and the Supreme Court.[12] The protection of the good faith of the acquirer of ownership rights to real estate registered in the Cadastre of Real Estate before January 1, 2014, or January 1, 2015, can therefore be considered broader than the protection provided by the Civil Code.

TEMPORARY BUILDING

A temporary building is a separate immovable thing, and it is one of the exceptions where the building does not become part of the land.[13] However, the concept of temporary buildings is not defined by the Civil Code, and almost immediately discussions emerged about the nature of the temporary building and the question of whether it will be possible to build on third party land as a separate thing after the Civil Code enters into force (i.e. without it becoming part of the land), such as under a lease agreement.

With regard to the principle of independent application of private and public law, the indecisive assessment by the building authority should be used to determine whether a building is temporary or not, i.e. whether the use of the building was permitted temporarily or indefinitely.[14]

Without defined criteria for temporary buildings in the jurisprudence of the Supreme court, we can assume with regard to the prevailing conclusions of the professional public that the main criterion for assessing whether a building is temporary or not is the builder's intention, i.e. how the building will objectively appear to third parties and whether it can be considered permanent or not in their view (e.g. with respect to its building structure).

Basically, the fact whether the title based on which the building is located on the property is temporary or not should not in itself determine the temporary nature of the building.[15] Building on third party land under a lease agreement after the Civil Code entered into force can therefore be quite risky.[16] We can conclude that without the case law of the Supreme Court, the surest way of establishing buildings on third party property (without these buildings becoming part of the land) is the acquisition of building rights.

PRE-EMPTION RIGHTS

With the amendment to the Civil Code no. 460/2016 Coll., the institute of statutory pre-emption rights in the case of the transfer of co-ownership shares in real estate is re-established, with effect from January 1, 2018. This may prolong the sale of real estate by several months.

The cancellation of statutory pre-emptive rights was one of the major innovations introduced by the Civil Code that was welcomed by real estate practice. The existing statutory pre-emption rights of co-owners pursuant to § 140 of Act no. 40/1964 Coll., Civil Code, expired with the expiration of one year from the date of entry into force of the Civil Code[17], i.e. on January 1, 2015. At the same time, the Civil Code newly modified the pre-emption right in the event that the co-ownership was established with acquisition for the event of death or another legal fact, so that the co-owners cannot influence their rights and obligations from the beginning. In this case, the pre-emption rights last for a period of six months from the date of the establishment of co-ownership,

Therefore, the statutory pre-emption rights for all transfers of co-ownership shares in real estate will be extended from January 1, 2018.[18] If a co-owner intends to

[10] According to the Constitutional Court (e.g. the decision of the Constitutional Court, File no. III.ÚS 415/15), the principle of good faith is one of the key manifestations of the principle of legal certainty.
[11] The main argumentative basis was the obligation to respect the jurisprudence of the Constitutional Court.
[12] Under § 984 of the Civil Code, if the status is not recorded in a public register in accordance with the actual status, this status gives testimony in favor of the person who acquired the real right for consideration (they will therefore be contractual transfers, not free of consideration) in good faith from the person authorized to do so according to the registered status.
[13] Under § 506 of the Civil Code, the space above the surface and below the surface, buildings built on the land and other facilities, with the exception of temporary buildings, are part of the land.
[14] Withal, the Supreme Court has already ruled on the possibility of using building regulations to define buildings in a civil sense, in its judgment with File no. 22 Cdo 1118/2005, in which it stated that "[V] when civil regulations use the term "building", this concept cannot be interpreted only by building regulations, because building regulations understand the term "building" dynamically, as an activity directed at implementing a work (but sometimes also as the work itself). For the purposes of civil law, the term "building" should be interpreted statically, as a thing in the legal sense."
[15] This temporary title will be mainly a lease agreement or an easement agreement.
[16] Today, builders have no legal certainty of whether the building will be considered part of the property. In this case, the rules set out in the part regarding the settlement of buildings located on third party land would apply.
[17] With the exception of pre-emption rights in the case of co-ownership of an agricultural or family enterprise.
[18] The Civil Code also regulates (i) the statutory pre-emption right of the building owner and the owner of the land, if it is a different person, (ii) the statutory pre-emption right of the tenant to the unit during its first transfer, if the unit is established by splitting the right to the house or land into ownership rights to units, or (iii) the statutory pre-emption right of the builder and owner of the land in the event of the acquisition of a building right.

dispose of his[19] stake, he will be obliged to offer its sale to a pre-emptor.[20] The seller's obligation to offer the sale of his stake to a pre-emptor only arises when the seller concludes a purchase agreement with a third party (i.e. who is willing to buy). Until then, the pre-emptor has no right or legal means to require the seller to offer him his stake for sale. After the conclusion of a contract with a party that is eager to buy, the seller is obliged to make the pre-emptor an offer with the announcement of the terms of the transfer.[21]

If the pre-emptor accepts the offer, the purchase between the seller and pre-emptor will take place basically under the same conditions agreed upon between the seller and the party willing to buy. The pre-emptor is obliged to pay the seller the purchase price within the agreed deadline; if there is no deadline, he is obliged to pay the seller within three months after the bid for the sale of the immovable property was made. If the pre-emptor fails to pay the price within this period, he can no longer seek to realize the purchase.

It is clear from the above that situations may arise where two contracts are concluded for one subject, whereas the application of pre-emption rights will not automatically terminate the contract with the pre-emptor. The Civil Code is trying to solve this problem in a way that if the party willing to buy knows about the pre-emption right (or must have known about it), the contract is concluded with a condition for the cancellation of the application of the pre-emption right.

Even after the reintroduction of the statutory pre-emption right between co-owners of immovable property, it will be possible for co-owners to waive their pre-emption right, even with the effects on their legal successor. In the case of immovable property registered in a public register, the waiver of the pre-emption right will also be recorded.[22]

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[19] The pre-emption right is used in the case of transfers for consideration and free transfers.
[20] The Civil Code defines a pre-emptor as a person in whose favor the pre-emption right is established.
[21] If the pre-emptor accepts the offer, the purchase between the seller and pre-emptor will take place under the same conditions agreed upon between the seller and the party willing to buy.
[22] The record of waiving the pre-emption right will be made with a comment.

INVESTMENT TRANSACTIONS IN TERMS OF LAW

Excess money in the economy, ample liquidity in financial markets, a lack of quality investment real estate and the resulting excess demand for quality real estate above its offer, is also reflected in the legal plane. The described excess affects the content of legal documentation negotiated for transactions, as well as the actual negotiation between the buyer and the seller. This trend has been evident since 2015, when the demand began to outweigh the supply.

Transactions last year also took place primarily through the sale of project companies owning the respective investment real estate (share deal), while the direct sale of investment real estate itself (asset deal) is still rare. In addition to significant hidden tax burdens for the buyer, the purchased investment product is "contaminated" by the long, often more than ten-year history of the company with a number of its previous owners. This poses risks that the seller is only partially prepared to reflect in the legal documentation and thus protect the buyer.

LEGALLY, THIS TREND IS REFLECTED IN THE FOLLOWING PLANES:

1) Negotiation of the intent of the parties (Letter of Intent)

It is obvious that during the negotiation of the intent of the parties, the seller has the maximum possible bargaining position. After granting exclusivity to a single candidate and the commencement of due diligence by this candidate, the seller's negotiating position gradually declines. In the case of multiple candidates interested in the given real estate, the seller has the option to negotiate in the agreement of the intention of the parties a substantial part of the future legal documentation, so that after he grants exlusivity to the final candidate, his position is simplified and as favorable for the seller as possible. This tactic is often used by sellers.

We frequently see agreements on the intent of the parties that not only include the basic parameters of the transaction, but also certain detailed arrangements for a future purchase agreement (share purchase agreement, SPA). These arrangements are primarily related to the seller's liability to the buyer for representations and warranties - namely the duration of the representations and warranties, the minimum and maximum financial limitations and a detailed description of the qualification of representations and warranties submitted in documentation for the performance of due diligence, but they also contain a complete list of all representations and warranties.

Legal issues that were usually only discussed in the past with the final single candidate within the SPA are now often discussed with multiple candidates already in the Letter of Intent stage. The ultimate consequence is the limited ability of buyers to assert the necessary level of protection in legal documentation in an effort to compete with other candidates, not only with the offered price, but also the amount (or limitation) of requirements to protect themselves from the seller.

2) Co-exclusivity

In the sale of very attractive investment real estate, we are beginning to see the granting of exclusivity for due dilignce and for the negotiation of the legal documentation of the transaction to multiple candidates, who are aware of the shared or joint exclusivity with other candidates and agree with it. The fact that multiple candidates (usually two, three at most) are admitted into the due diligence process and the negotiation of the legal documentation, is extremely difficult for the seller.

This creates substantial transaction costs for multiple potential buyers (costs for due diligence consultant, costs associated with negotiating the legal documentation, etc.). For those candidates who do not end up winning the real estate, these transaction costs are incurred unnecessarily. It is therefore not uncommon for sellers wishing to perform this kind of negotiation to compensate the unsuccessful candidates for part of these costs incurred. The compensation ranges between 50% and 100% of costs for conducting due diligence.

The seller can also conduct the due diligence in advance at his own expence with his own consultants, and disclose the results to candidates in a way that the buyers can fully rely on the results of such due diligence. Of course, this means that the seller's consultants must be sufficiently experienced in the given field and have a sufficient reputation, so that the results of due diligence are acceptable to the candidates. The buyer then conducts his own due diligence on a limited scale, which is therefore much cheaper than usual.

3) Title insurance and warranty & indemnity insurance

Real estate title insurance as a replacement (substitute) or completion of the real estate title warranty by the seller is a well-known and frequently used product in the Czech market. This product is offered by a number of foreign insurance companies - some well-established in the Czech Republic for many years, but some of them entered the Czech market quite recently and are only beginning to build their position in the title insurance market.

The trend among insurance companies is to fight for a market position, which is reflected in the expansion of title insurance offers by a title to shares or stock of a company being sold. Insurance companies want to make their offer more attractive, and they are prepared to assume a significant part of the seller's responsibility for the required premium, namely the part of the responsi-

bility that carries with it the requirement for the seller's sufficient financial coverage, demonstrating his future ability to meet the liability commitment for the title on the real estate or the company being sold.

The fact that sellers may significantly limit their representation and warranty liability due to the overhang of demand over supply, brought to the market the insurance of all representations and warranties from the purchase agreement, and therefore the assumption of either significant or complete post-sale liability on behalf of the seller by the insurance company. Although this product is well-known and used in the Czech market, the resolution of insurance claims and resulting performance of insurance companies is still minimal, and the experience of most players in the real estate market and their consultants is still rather limited.

Given that a large part of sales transactions on the seller's part is carried out with foreign real estate, and investment funds and companies that distribute the proceeds from the sale to their investors immediately after the transaction and enter into liquidation, comprehensive insurance of all representations and warranties from the purchase agreement is often the buyer's only possible protection.

Another not entirely insignificant factor is the cost sharing for both types of insurance (titles and other representations and warranties). We often see a trend where these costs are either entirely borne by the buyer and are therefore included in the offered price, or they are shared equally by the buyer and seller, or the seller contributes to the costs with a predetermined fixed amount.

4) Limitation of liability for representations and warranties

A standard duration of warranties and the seller's representations in favor of the buyer does not exist in the market; the differences between individual transactions are still significant. The duration of representations and warranties is typically in the following range:

A. Warranties of a title to business shares/stock: 2–4 years
B. Warranties of a title to real estate: approx. 3 years (sometimes even 10 years)
C. Tax warranties: 3–5 years, sometimes indefinitely, as long as the tax years subject to inspection by the tax authority can be closed
D. Other representations and warranties: 1–2 years, exceptionally 3 years

Financial contractually agreed limitations of the seller's liability (minimum and maximum amount limit) are also not fully standardized, although we can see a certain degree of unification in the approach. Typical financial limitations are as follows:

A. De minimis: 5 000–30 000 EUR
B. Minimum amount of claim: 0.3 % to 1 % of the transaction value
C. Maximum amount of claim: 5% –15% of the transaction value
D. The maximum claim amount on a title to real estate and a title to business shares: 100% of transaction value, or completely replaced by the insurance of both titles, as described above.

It is quite common in the real estate market that representations and warranties are limited (qualified) by all the documentation that the seller submitted to the buyer and his consultants for their due diligence. In very rare cases, some representations and warranties made available in such documentation for due diligence are not limited/qualified. This includes representations regarding the seller himself and his permission to execute the transaction, representation on the title to the company being sold, representations regarding past taxes and a number of other selected representations. Even here, however, the excess demand over supply is reflected in the buyer's decreased legal comfort.

Despite the limitations in the legal comfort of buyers in the Czech market described above, it should be noted that the delinquency rate (the rate where representations and warranties are breached by the buyer or when the buyer registers the materialization of a risk arising from the past and related financial damage) is very low, approximately around 2% of completed transactions

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REAL ESTATE ACQUISTION TAX – THE ACQUIRER IS ALWAYS THE TAXPAYER

It has been three years since the real estate acquisition tax replaced the original property transfer tax. The statutory measure of the Senate No. 340/2013 Coll., on real estate acquisition tax, remained in its original form until the autumn of last year. On November 1st, 2016, the amendment to statutory measure of the Senate made by Act No. 254/2016 Coll. came into effect.

The explanatory memorandum of the amendment declares that its ultimate aim is to eliminate deficiencies that occurred in practice, to specify the regulation and to remove ambiguity. However, the amendment also brought a number of changes that undoubtedly affect the behavior and decision making of the real estate market participants.

RADICAL CHANGES

The real estate acquisition tax is a direct tax, which means it enables to identify the person who is a taxpayer accurately. As the name of the real estate acquisition tax implies, it appears that the taxpayer is always the acquirer, however until the amendment became effective it used to be the exact opposite in case of purchase contracts in respect of real estate. In fact, the statutory measure used to provide that in case of purchase or exchange of real estate, the transferor shall be the taxpayer unless the parties of the contract agreed otherwise.[1]

The most important changes brought by the amendment can be summarized in three following points:

- Since the amendment came into effect, the concept of the real estate acquisition tax has returned into its originally intended form and the acquirer shall be the taxpayer in all cases.
- In this context, another major change is the fact that it is no longer possible for contracting parties to agree that the transferor shall be the taxpayer.
- The institute of liability has been completely removed from the legal regulation of the real estate acquisition tax.

All this brings both positive and negative consequences for the contracting parties which we will touch upon further.

The memorandum to the amendment is optimistic regarding its effects on tax administration. It declares that financial authorities will have easier time in finding and identifying the taxpayer, since his/her personal data will be available in the land register. Furthermore, the acquirer is more motivated than the transferor to actually pay the tax, as he/she is the new owner of the property, which could be, although only in extreme cases), the object of execution proceedings for non-compliance with his tax obligations.

THE EFFECTS OF THE AMENDMENT ON PARTIES TO THE TRANSFER AGREEMENT

Purchase price

So far, the transferor had to increase the purchase price to compensate for the expected tax. With the new legislation, the transferor is entitled to the whole purchase price, not only to the current 96 %, as he/she is no longer the taxpayer and is not therefore required to add the amount corresponding to his/her projected tax obligation to the purchase price. The transferor is also no longer required to allocate and hold the corresponding amount of funds for the future payment of the tax to the tax administrator.

The acquirer is now the one who has to expect to incur a total consideration of 104% of the purchase price (in addition to possible real estate office commissions, remunerations for legal services or other costs).

Total consideration (purchase price + real estate acquisition tax)

Prior to the amendment coming into effect, the transferor who intended to sustain an amount of CZK 1,000,000 needed to set the purchase price at about CZK 1,041,667, from which he/she paid a tax of 4 % = CZK 41,667 after rounding to whole crowns.

Nowadays, if the set purchase price is CZK 1,000,000, the acquirer has to pay a total consideration of CZK 1,040,000 of which the transferor will sustain CZK 1,000,000. The tax liability of the acquirer will be lower than the tax liability of the transferor in the previous case (tax in the amount of 4 % of the purchase price CZK 1,000,000 = CZK 40,000).

The abovementioned example demonstrates that shifting the tax liability from the transferor to the acquirer does not a priori present a disadvantage for the contracting parties, since the overall consideration associated with the transfer is actually reduced by a certain amount. It can be stated, however, that the previous case of increasing the purchase price was more favorable for the state budget.

[1] An interesting fact is that this regulation (transferor being a taxpayer) was only introduced into the statutory measure at the very end of the legislative procedure and it was not even the subject of proper reflection process. Therefore it is no surprise that such solution proved to be unfortunate in practice.

For the sake of completeness it should be noted, that abovementioned second case of total consideration (CZK 1,040,000) could be also reached according to the previous legislation with the agreement of both parties (i.e. the parties agreed that the acquirer will be the taxpayer, who pays 4 % of the CZK 1,000,000 purchase price = CZK 40,000, with a total consideration of CZK 1,040,000).

A significant negative consequence of such agreement however was that the acquirer had put on himself/herself the obligation to file a tax return. Moreover, the acquirer bore the risk of paying additional tax, if such was added by the tax administrator. In order to avoid these risks a relatively complicated modification of contractual relationship between the contracting parties had to be created.

Mortgage

The change in legislation brings potential inconveniences for the acquirer consisting of an increase in the total consideration for the acquisition of the property caused by the presence of real estate acquisition tax, since this tax is not included in the purchase price, however is the acquirer's direct tax liability. Question, whether the tax may or may not be paid from the mortgage funds logically arises.

Mortgage as a purpose loan should, strictly speaking, be used to finance the purchase price of real estate, not to finance taxes. The bank could therefore refuse to provide the loan in the extent corresponding with the estimated amount of the tax, which might cause a difficult dilemma for the acquirer whether he/she is able to pay the tax from his/her own funds, or whether to opt for expensive non-purpose loan.

If the bank also requires a down payment as condition to provide a loan (generally at least 10 % of the purchase price), this means that the client's own funds must reach the amount of 14 % of the purchase price. For example when the purchase price is CZK 5,000,000, the tax amounts of CZK 200,000. Such tax together with the requirement of 10 % of the client's own funds (= CZK 500,000) amounts of CZK 700,000. This fact might represent a substantial obstacle for many people who are interested in residential housing. Achieving the goal of living in our own home is again a bit more complicated.

In practice, the experience seems to be positive, whereas the mortgage banks approach this problem creatively. Some of them agree to finance the tax under the condition that the tax is included in the purchase price in the respective transfer agreement. In such situation, the parties, or rather their legal representatives are encouraged to find an optimal solution consisting in ingenious wording of the relevant clauses of the agreement for the transfer of property.

In cases where the bank is only willing to finance the real estate acquisition tax if it is included in the purchase price, it is necessary to adjust the provision regarding the payment of the purchase price in the agreement accordingly. In practice, we have seen cases where the parties agreed that the purchase price will be paid when its full amount is deposited onto an escrow account. In such case, the custodian releases the amount corresponding to the estimated tax to the relevant tax authority according to and under an escrow agreement, doing so after the submission of the acquirer's tax return. The remaining 96 % of the purchase price is of course released to the transferor.

If the transferor expressly agrees in the transfer agreement that the acquirer's obligation to pay the purchase price is fulfilled in the moment of the deposition of the full amount of purchase onto an escrow account and that only 96 % of the purchase price will be released to the transferor's account, this procedure de facto represents the fulfillment of the acquirer's tax obligation by the transferor. Although someone may consider this method as shaky, it is always up to the will of the parties to negotiate the content of their obligations in compliance with one of the fundamental principles of our private law – the principle of freedom of contract. It seems that only practice will show whether this solution is "foolproof".

We do not believe, however, that a tax authority would intervene. If a tax return is filled properly by the acquirer and if the tax administrator files the tax obligation as fulfilled, the administrator will likely not investigate who specifically had paid the amount. However an imaginary question mark might stay hanging over the acquirer´s head during the limitation period, representing his/her fear – whether the transferor will eventually decide to claim the additional payment of 4 % of the purchase price, which he/she never actually received, possibly with the statutory interest.

Liability

Another indubitably positive aspect of the amendment is the termination of the institute of the acquirer's liability for the fulfillment of the transferor's tax obligation. The liability legislation used to cause a need to adequately adjust the transfer agreements in order to eliminate the risks for the acquirer arising out of such liability. Whether the transferor will actually pay the tax or not was never under the acquirer´s control. He/she could therefore learn about his/her tax obligation arising out of his/her liability after several months, surprised and short of the necessary funds.

Transfer and escrow agreements almost always contained provisions on the conditions for the payment of the tax, in order to avoid the risk of application of liability. This, however, often greatly complicated the negotiations on the contents of the agreements.

It used to be typical that parties agreed on releasing of the amount of the tax from the escrow account directly to the tax authority´s account, rather than to the transferor's. In order to avoid the risk of additional tax, it was always convenient to accompany the purchase contract with the expert's opinion regarding the price of the property.

Some acquirers also used to ask the other party to submit a confirmation of the tax administrator proving that the buyer has no outstanding payments towards the tax office. All this was done to avoid a situation, where the amount that should had originally be used to pay the real estate acquisition tax, is set off by the tax administrator for his receivable from the transferor arising from his/her failure to pay any other taxes including all penalties and other accessories. Finally this is no longer necessary with the new amendment and it is also obvious that the amendment has brought a positive change that will lead to a significant simplification of contractual relationships.

OTHER CHANGES

Exemption of new buildings

Those who are interested in buying a building or unit under a construction are surely not pleased by the fact that with the introduction of the new amendment, the first transfer of ownership title to such real estate under

construction is no longer an exempt of the real estate acquisition tax. Given that buildings under construction are not registered in the land registry, complications for tax administrators used to arise since they were not able to verify whether the transfer of the ownership title to such real estate is really the first transfer. The exemption will continue to apply only to finished buildings and units, occupied or prematurely occupied, all in the sense of construction regulations.

The tax exemption will take place in accordance with paragraph 7 section 2 of the statutory measure only if acquisition of ownerships title to real estate takes place in a period of 5 years from the date of completion or commencement of use of the house, unit in an apartment building or unit in an apartment building changed with construction modifications, from whichever day comes sooner. Therefore the tax needs to be taken into account if the acquirer chooses to buy the building/unit under construction and to finish it by himself/herself. While trying to optimize costs, acquirers face a new unknown question of whether it is better to: A) buy an unfinished property, pay the tax and finish the construction by themselves in accordance with their wishes; or to B) buy the finished property and deal with the transferor about all construction alterations, and pay for them extras, of course.

Property exchange

Another change brought by the amendment which is by the way referred to by the authors of the chapter "Property taxes", is the simplification of the procedure for determining the taxable amount in case of the property exchange. In case of real estate exchange between two parties in which the acquisition of ownership titles is subject to tax, the value of the exchanged property will be disregarded for the purposes of the agreed price, provided that the acquisition value is not exclusively the agreed price. Therefore, if one party gives the other party an additional monetary payment, then the agreed price will be equal to the amount of this monetary consideration.

Taxation of public utilities

The area of the taxation of public utilities was also simplified. The public utilities themselves are not subject to the real estate acquisition tax (e.g. sewer or water pipelines), but if the building is a part of such public utility, then the building will be the subject of taxation.

Generally the acquisition of immovable property for consideration is a subject to the tax on acquisition of real estate – and such real estate namely means the land, building, unit, the right to build or the co-ownership share of the real estate. Given that there is still no clear consensus among the professional public on whether public utilities are movable or immovable property, the tax administrator was allegedly put in a position in which he/she assessed the legal nature of the respective public utilities and such topic is a matter of private law, not the public law. The amendment to the statutory measure solved the aforementioned problem cleverly – as it was already indicated above, nowadays only the acquisition of the building (or the co-ownership share of it) will be taxed, provided that such building is a part of public utility, is transferred for consideration and meets the criteria according to the Cadastral Act.

GENERAL INFORMATION ABOUT THE REAL ESTATE ACQUISTION TAX

The real estate acquisition tax is a property tax derived from the acquired real estate property. Even after the amendment, the tax rate remains 4 % and it is dependent on the acquisition value (i.e. the agreed price, comparative tax value, determined price or special price) minus the deductible expenses – expert remuneration and costs of an expert opinion, provided that such expert opinion is a compulsory annex to the tax return.

Like other kinds of taxes, the real estate acquisition tax is not a popular subject among the general public. The main arguments are that the real estate acquisition tax is causing an increase in prices of real estate and impeding the construction, and that the tax causes double taxation, since the property is purchased from funds that were already taxed.

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