

TRANSFORMATION OF PERPETUAL USUFRUCT RIGHT INTO OWNERSHIP TITLE

Perpetual usufruct right is an intermediate right between ownership title and a restricted right in rem (such as usufruct or an easement or pledge). Despite its advantages, perpetual usufruct right has a number of shortcomings, such as the requirement to pay annual fees and the fact that it is limited in time (generally to 99 years from the time it is granted).

However, perpetual usufructuaries do have a statutory right to transform their perpetual usufruct right into full ownership title and the procedure for this is summarised in this briefing.

Introduction

As the law currently stands, there are two basic procedures enabling a perpetual usufructuary to obtain ownership title to real property.

The first procedure is regulated by Art. 32 of the Act on the Management of Real Properties¹ (the "Act on Management"). This allows the perpetual usufructuary to file an application for the sale of ownership title to the property and then for such perpetual usufructuary to acquire ownership title from the relevant local governmental authority or the State Treasury.

The second procedure by which a perpetual usufructuary may acquire ownership title to real property is provided for in the Act on the Transformation of the

Key issues

- History
- Eligible persons
- Proceedings for transformation
- Decision on transformation
- Fee for transformation

¹ consolidated text: Journal of Laws of 2010, No. 102, item 651

Perpetual Usufruct Right Into Ownership Title of 29 July 2005² (the "Act"). This is of far more use to perpetual usufructuaries and was passed to reflect a move in the market away from perpetual usufruct.

The first procedure is discretionary and depends mainly on the relevant governmental authority that is the owner of the property which may dismiss the application and refuse to sell the real property concerned. Therefore, the second procedure seems to be much more effective. This is because it creates a right to require title to be transformed into full ownership, and an application may not be dismissed if the relevant conditions are met. Due to this fact, the rest of this briefing summarises this procedure.

History

As indicated above, the Act was enacted on 29 July 2005 and initially its application was limited, as the original wording of the Act permitted only natural persons (and to a limited extent legal persons) who were in possession of real property designated for residential purposes to transform their perpetual usufruct right into ownership title.

Despite the limited scope of the Act, after it was passed there was a marked increase in the number of applications to transform perpetual usufruct right into ownership title. This was, and continues to be, a result of the increasingly higher fees that perpetual usufructuaries are forced to incur each year. The perpetual usufruct fee is based on the current market value of the relevant property. Consequently, as the market value of property has gone up generally in Poland, so have the annual perpetual usufruct fees.

In the eight years since the Act has been in force, it has been amended several times to adjust it to changing market conditions. The most recent amendment, which came into force on 9 October 2011, abolished most of the limitations contained in the original wording of the Act, such as restrictions concerning the eligible persons that may apply for transformation or the type of the property which might be subject thereto.

Eligible persons

The right to make an application for transformation is only vested in a perpetual usufructuary who held perpetual usufruct title to the relevant property on 13 October 2005.

The right cannot be exercised by a state or local governmental authority or a company in which the State Treasury or a local governmental authority was the dominant entity. However, any other legal or natural person can exercise this right (both Polish and foreign).

If, after 13 October 2005, a perpetual usufructuary fulfilling these criteria sold its interest, the right to request the transformation of perpetual usufruct into ownership title passes to its legal successor.

² consolidated text: Journal of Laws of 2012, No. 0, item 83

So far, there has been no doubt that, for example, an heir may be a legal successor. However, there was much debate as to whether a purchaser that purchased a right of perpetual usufruct could be a legal successor. However, the practice of the relevant public authorities is to agree that a purchaser of perpetual usufruct from someone who held that title on 13 October 2005 (and any subsequent purchaser that is eligible to exercise this right) also has the right to apply for that right to be transferred into ownership title. This practice is also consistent with our interpretation of the relevant provisions.

In these circumstances, the history of the chain of acquisition of the perpetual usufruct right has to be described in the application for transformation.

This chain can be broken if at any time the perpetual usufruct was held by a person which was ineligible to apply for transformation, as referred to above.

Eligible real estate

The right to apply for transformation of perpetual usufruct applies to all real property irrespective of its function and designation. This removes restrictions contained in the previous law whereby, for example, it was not possible to transform perpetual usufruct for property used for industrial purposes. Currently, the type and designation of the land are irrelevant to the transformation.

Proceedings for transformation

When the eligible person files an application, the competent authority, which is the village head (wójt), mayor, president of the town/city or starosta, then has to start the relevant procedure.

If an eligible applicant satisfies all the requirements provided for in the Act, the authority cannot refuse to carry out the transformation and must issue a decision on transformation. Although the authority is obliged to examine the perpetual usufructuary's application for transformation within a statutory time limit, which is usually two months, often no action is taken. In such a case, the perpetual usufructuary is protected against the authority's inaction by way of a claim in respect of the authority's failure to act, which is examined by the voivodeship administrative court. In its judgment, the voivodeship administrative court requires the authority to issue the decision within a prescribed time limit. Irrespective of the above, during the transformation procedure, on the instructions of the relevant authority, the real property is valued so that the fee for the transformation can then be calculated (see below for details on how the fee is calculated). The market value of the real property and the value of the perpetual usufruct right are determined by a property valuer³ in a valuation report.

³ The property valuer is appointed by the relevant administrative authority from among qualified professionals from a list maintained by the Minister of Infrastructure.

Decision on transformation

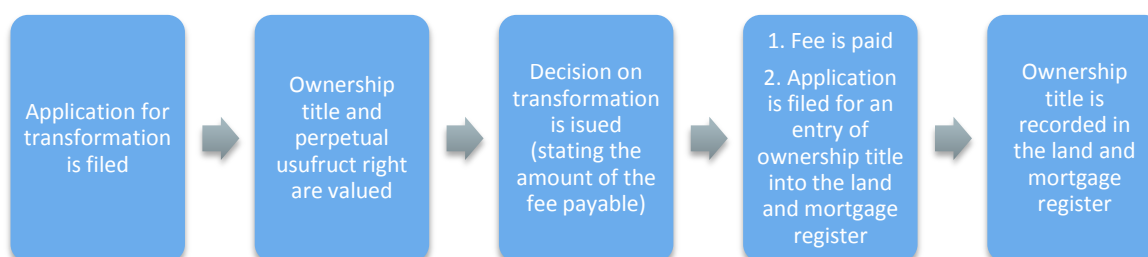
After the application for transformation has been examined and the valuation carried out by the property valuer has been taken into account, the wójt (or the mayor or president of the town/city) or the starosta issues a decision on the transformation, in which he/she specifies the fee that the applicant must pay for the transformation (see below).

Once the decision becomes final, i.e. after the expiry of the time limit for any appeal against, for example, the perpetual usufructuary's dissatisfaction with the results of the property valuation, the perpetual usufruct right is transformed into ownership title and the final decision forms the basis for the appropriate entry in the land and mortgage register.

However, it should be stressed that acquisition of the ownership right to the property as a result of the transformation of the perpetual usufruct right **does not enjoy the public warranty of land and mortgage registers**. Under Polish law, only the acquisition of ownership title through a **legal transaction** executed with a person authorised according to the entry in the land and mortgage register benefits from such a warranty. As the transformation is not an act in law but only a unilateral act of an administrative authority, this the statutory provision does not apply.

If the applicant does not pay the fee for transformation within seven to 14 days of the decision becoming final (the time limit depends on the practice of the relevant authority), the unpaid fee will automatically be secured by a mortgage over the property arising by operation of law.

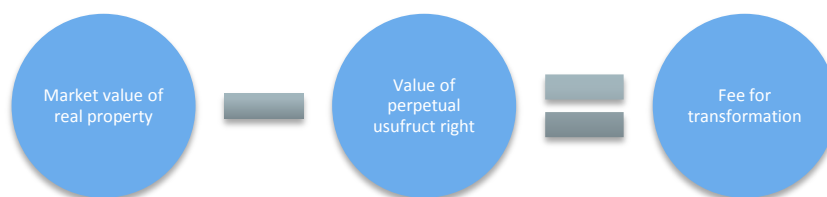
Summary steps in acquiring ownership title



Fee for transformation

As already mentioned, the fee for transformation is calculated on the basis of a valuation report prepared by a property valuer. The basis of valuation is governed by Act on Management and the Ordinance on the Valuation of Real Properties and Preparation of Valuation Reports⁴ (the "Ordinance").

Pursuant to those provisions, the fee for transformation is the difference between the market value of the real property and the value of the perpetual usufruct right to the real property, determined as at the date of transformation.



When valuing the perpetual usufruct right, the property valuer assesses the value of the relevant land on an undeveloped basis. That value is then multiplied by the so-called "adjustment index". This index takes into account factors such as the number of unexpired years of the perpetual usufruct, the number of years for which the perpetual usufruct was established, the average rate of capitalization⁵ determined on the basis of research carried out on the property market by the property valuer (no lower than 0.09 and no higher than 0.12) and the percentage rate of the annual fee.

The property valuer does not value the perpetual usufruct right if, in the two years before the date on which the application to transform the perpetual usufruct right into ownership title was filed, the annual perpetual usufruct fee for the real property was adjusted to the market conditions. In this case, the value of the real property determined for the purposes of that adjustment⁶ is used to calculate the fee for transformation.

The perpetual usufruct fees paid in the past and the fees that the perpetual usufructuary would have to pay during the remaining term of the perpetual usufruct are supposed to be irrelevant to the valuation. The only factors taken into account are those that the property valuer takes into account when calculating the adjustment index, that is primarily the number of years for which the perpetual usufruct was established and the number of years which have expired.

The formula set out below describes the valuation principles used:

⁴ Journal of Laws of 2004, No. 207, item 2109

⁵ In this case, the average rate of capitalization means the average ratio between the net operating income produced by the real property and its capital cost (the original price paid to buy the asset).

⁶ In such a case, the property valuer will apply the comparative methodology, which basically depends on the current market value of the property as undeveloped land, without the necessity of using the adjustment index described above.

$$Wk = \left(1 - \frac{Sr}{R}\right) \cdot \frac{t}{T} + 0.25 \cdot \frac{T-t}{T}$$

- Wk - adjustment index,
- Sr - percentage rate of the annual fee, no higher than 3%,
- t - number of years of the unused period of perpetual usufruct,
- T - number of years for which perpetual usufruct was established,
- R - average rate of capitalization determined on the basis of research carried out on the property market by the property valuer (no lower than 0.09 and no higher than 0.12).

Example

Let's assume in 2000 perpetual usufruct title for 99 years is created over some land designated for the construction of a shopping mall. In 2012, the perpetual usufructuary of the land applies for the transformation of its perpetual usufruct right into ownership title.

In this situation, when estimating the value of the perpetual usufruct, the property valuer will take into account the 99-year period for which the usufruct was established, the 87-year unexpired period of the perpetual usufructuary, the percentage rate of the annual fee (3%⁷) and the rate of capitalization (from 9% to 12%), which will be calculated based on research carried out in the property market. The value calculated in this way will then be multiplied by the estimated value of the land as if it were undeveloped (even if, in fact, there is a building located on it). The final fee for transformation is the difference between the market value of the ownership title to the real property and the value of the perpetual usufruct right as determined in accordance with the method set out above.

The fee for transformation can be paid in instalments over a period of 10 to 20 years. It then bears interest according to the rediscount rate for promissory notes charged by the National Bank of Poland (this is currently 3,50%).

Any appeal in respect of the process (including the valuation) can only be made once the decision of the relevant authority is issued.

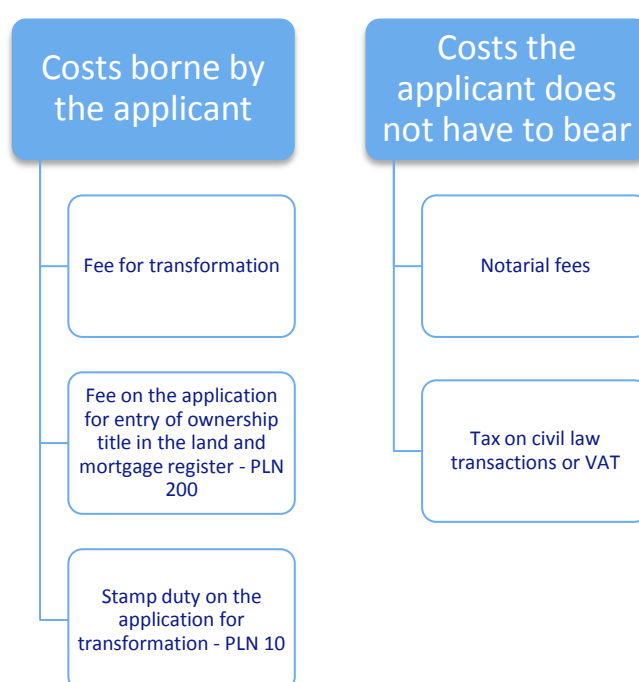
Costs and taxes

Pursuant to a judgment of the Supreme Administrative Court of 5 April 2012 (case no. I OSK 16/12), all the costs of valuing any real property during the transformation process are borne by the relevant state authority. Consequently, the applicant is

⁷ Pursuant to Art. 72 sec. 3 point 5 of the Act on Management

not obliged to bear any of the administrative fees, including the cost of the valuation report. However, the applicant still has to pay a filing fee of PLN 10.

The diagram below summarises what costs and taxes are borne by the different parties to the procedure:



No VAT is payable on the transformation fee. Furthermore, no tax on civil law transactions is payable on the transaction (a form of transfer tax which is payable on a conventional sale of real estate by the buyer).

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