Legal opinion

Conversion of perpetual usufructs to freeholds, one year on

On 20 July 2018, the Sejm enacted an "Act on the transformation of the right of perpetual usufruct of housing properties into freehold ownership" (henceforth "the Act"), which provided for the conversion of perpetual usufructs of housing properties to freeholds as of 1 January 2019. One year on is a good time to reflect on how the Act is working out in practice.

The intent of the Act was to solve problems arising in the implementation of the Act of 29 July 2005 on the transformation of the right of perpetual usufruct of real estate into freehold ownership, and also to eliminate tensions between perpetual usufruct holders and property owners over increases of annual usufruct fees. But while the idea of converting housing usufructs to freeholds is a commendable one, putting it into practice has proved tricky. The Act itself, as it quickly became clear, contained many ill-thought out provisions, and it has had to be amended several times since. Here are the most important of these changes from a business perspective.

The Act was amended for the first time already in December 2018, i.e. even before the conversion date, to avert possible bankruptcies among property developers and housing cooperatives. The threat arose because under the Act's original text, all perpetual usufruct holders, including businesses, were to pay the conversion fee over a period of 20 years (i.e., in 20 yearly instalments). For businesses, this would have meant exceeding the limit for 'de minimis' state aid, and an obligation to return this aid. (It was estimated that they would have had to return around 80% of the property's value.) The amendment addressed that by giving businesses a choice between paying the fee over 20 years, or over a longer period of time (in principle, 99 years).

Another amendment, passed in July, grew out of a realisation that the Act's wording effectively blocked conversion where the property had any structures on it, such as press shops, billboards, or transformer stations, not directly related to the residential function. In such cases, the parts of the property on which such structures were located had to be carved out into separate land plots with their own land register entries for the conversion of the residential buildings to take place. Under the amendment, structures or facilities of a non-residential nature (or serving non-residential purposes) are no longer a barrier to conversion, as long as their combined usable floor area does not exceed 30% of the total usable floor area of all buildings on the property.

Another problem that required alterations to the original Act – they were passed in June – was that it stated that businesses had three months from the date of conversion (i.e., 1 January 2019) to apply for their payment period of the conversion fee to be longer than 20 years. Failure to do that meant that the period was 20 years, again causing businesses to exceed the limit for 'de minimis' state aid. Pursuant to the June amendment, businesses have until the day of receipt of the certificate of conversion to state their preferred payment period, and in case of failure to do that, a period longer than 20 years applies. Businesses that fail to state their preferred payment period in time can still ask for a change to 20 years for properties which they do not use for business activity. They have to enclose a declaration that they do not use it for business activity (as defined by the Law of Entrepreneurs), or an application for state aid, along with other documents required by applicable laws.

The June amendment also made it possible to pay separately the part of the conversion fee applicable to the part of the property used for business activity and the part of the fee applicable to the remaining part of the property.

Also amended was the provision that lays down how to calculate the extra charge – covering the difference to the property's market value – that has to be paid when the limit for 'de minimis' state aid is exceeded. This charge can now be determined on the basis, either of the valuation used in calculating the annual usufruct fee for the property, or a new valuation performed at the request of the entity required to pay the charge (and at its expense). The competent authority has no power to establish a new value for the property. Unless the interested party requests a new valuation, the value on which the annual usufruct fee is based will apply. The charge is set ex officio through a decision.

Many more issues have arisen in the implementation of the Act than those addressed by these amendments, however. For example, the deadline of one year for authorities to issue certificates of conversion has proved impracticable. Also, in many cases, the data on properties that authorities have at their disposal are incomplete or inconsistent. In such cases, authorities rarely decide in usufruct holders' favour, and tend to refuse to issue certificates of conversion.

Another problem is that the Act does not say clearly how the proportion of the usable floor area of all buildings on a property that non-residential structures account for is to be established. Some authorities do the calculations themselves, or work on the basis of declarations made by owners under pain of criminal liability. Others demand that owners submit detailed tallies, passing on to them the often considerable cost of inventorying floor areas.

The Act does not cover properties not built up for housing, even if they are functionally related to properties built up for housing – such as e.g. internal roads or green spaces on residential estates that are technically separate plots with their own land registry entries. The first court rulings issued on the basis of the Act confirm this interpretation. This leads to absurd situations where usufruct holders become owners of the property that contains a residential building but not of its servient property that contains a road. The same will be the case with properties where non-residential structures account for more than 30% of the total usable floor area of all buildings: as the parts with non-residential structures are carved out into separate plots that remain subject to perpetual usufruct (with all the attendant financial restrictions and burdens), the same entities will be owners of the (pared-down) residential properties but usufruct holders of the related non-residential properties.

A year on from its coming into force, the conclusion has to be that the Act on the transformation of the right of perpetual usufruct of housing properties into freehold ownership, regardless of its various amendments, is not living up to its promise.

Anna Czajkowska
Counselor at Law
Miller, Canfield, W. Babicki, A. Chelchowski i Wspolnicy Sp.k.