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Buying and Selling Real Estate in Czech Republic

ILN REAL ESTATE GROUP



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KEY FACTS OF REAL ESTATE ACQUISITIONS UNDER CZECH REPUBLIC LAW

I. Types of Real Property Transactions

- a) Purchase of an undeveloped plot of land;
- b) Purchase of a developed plot of land;
- c) Purchase of a building (that is not a part of a plot of land);
- d) Purchase of an apartment;
- e) Purchase of a right to build;
- f) Purchase by way of a share deal through a corporation that owns the real estate.

Note: The right to build is a *right in rem* related to a plot of land consisting in a right to have an above ground or underground structure on that plot of land, regardless of whether such a structure has already been built or is yet to be built. Under Czech law, a right to build is as an immovable asset.

II. Essential Contents of the Purchase Agreement

- a) The contracting parties, as well as the purchase price and the payment terms.
- b) Exact description of the real estate, i.e., the land, any fixtures and fittings of the building or apartment and existing appurtenances, easements, pledges, etc. Czech law expressly prescribes how the land and buildings ought to be described in order to be successfully included in the Land Registry. The Land Registry contains all of the necessary components of the description required for the registration; it is thus advisable to extract the required information therefrom.

Note: A thorough review of the information lodged with the Land Registry is of major importance when gathering information on

the realities of the seller's title to the property, existing mortgages, and possible ongoing proceedings the property may be subject to. The register also contains records called "notices" which convey important information regarding the registered property or its owners or people holding any other rights to the registered property, for instance – information regarding dispossession, ongoing enforcement proceedings, prohibition of disposition, and prohibition on the establishment of a pledge.

- c) Description of the necessary repairs or other regulations the seller/buyer has to comply with.
- d) Date when the property was handed over to the buyer or the agreed upon date of transfer of ownership of the property (N.B. the ownership of the property is transferred on the day of registration in the Land Registry retroactively on the day of the filing of the request).
- e) The conditions of the change of ownership.
- f) Potential charges on the property.
- g) A declaration regarding the mandatory municipal permits, such as, for instance, the occupancy permit determining the permitted purpose of the use of the real estate.
- h) Detailed representations and warranties regarding the current rights and titles to the property; substantial characteristics of the property such as: access thereto, access to utilities (gas, electricity, etc.)
- i) The Energy Performance Certificate of the building must be obtained by the



seller and handed over to the purchaser, it is thus recommended to include it in the purchase agreement as an annex thereto.

Note: The parties may choose to include several collateral provisions in the purchase agreement, which may be constituted as rights in rem and registered in the Land Registry. Such collateral provisions may facilitate the negotiation of the sale of property by ensuring both parties' specific requirements are satisfied. The parties may choose to include the following collateral provisions in the purchase agreement: (i) reservation of ownership right, (ii) reservation of repurchase, (iii) reservation of resale, (iv) pre-emption right, (v) purchase testing or (vi) reservation of a better buyer. A detailed description of these stipulations exceeds the scope of this article, however, their inclusion in the purchase contract may prove very practical in individual cases. We will gladly provide more detailed information upon request.

III. Conclusion of the Purchase Agreement

- a) The purchase agreement has to be concluded in writing and the signatures of both parties must be on one document. As the Land Registry office investigates the authenticity of the parties' signatures on the purchase agreement, it is advisable that the parties officially certify their signatures. For the purpose of the registration in the Land Registry (i.e., for the filing of the application for the permission to enter a record into the Land Registry), it is not required that the parties to the contract prove their identities by their officially certified signatures.

IV. Transfer of Ownership

- a) The parties are advised to stipulate in the purchase agreement which party is to apply for the registration in the Land Registry. In most cases, it is stated that the seller has to apply for the registration in the Land Registry within a certain period of time from the conclusion of the purchase agreement. To ensure that the purchase price is paid to the seller after the registration of the ownership of the property in favor of the buyer, the parties usually escrow the purchase price at a notary, attorney-at-law or bank. The parties to the contract thus usually also conclude an escrow agreement with the bank, notary or attorney-at-law, along with the purchase agreement. Under run-of-the-mill escrow agreements, the bank/notary/attorney-at-law is obliged to transfer the purchase price after the fulfilment of the conditions stated in the escrow agreement, which typically is only the registration of the buyer in the Land Registry as the owner of the transferred property.

V. Agents

- a) The Buyer or Seller may employ the services of a real estate broker. The contract with the broker is most often concluded as an exclusive agreement.
- b) The real estate broker's commission is generally determined by the market situation and is usually between 3 and 5 % of the purchase price.

VI. Forms of Ownership

- a) In general, all individuals and legal entities can invest into and own real estate assets.



- b) It is irrelevant if the owners and purchasers are residents or non-residents, or which country they come from. However, it is important that the Czech Land Registry recognizes the legal personality of any foreign company or individual.
- c) Recently many international sanctions were and are still being imposed by the USA and European Union on various entities and individuals. Property transactions with most people and entities subject to sanctions are not allowed in the Czech Republic. Therefore, counterparties must be checked diligently from this perspective and appropriate approach chosen case by case.

VII. Acquisitions

- a) Properties can be acquired by way of an asset deal or a share deal. The legal entities involved in a share deal are mostly organized as limited liability companies or joint stock companies.

A. Residential Property

Residential property is most often owned by natural persons. Most frequent forms of ownership of residential property by natural persons are:

1. **Sole ownership:** The owner is the only person authorized to control and dispose of the property in question.
2. **Co-ownership:** More than one person owns an undivided share of property. Each co-owner is entitled to dispose of their share.
3. **Community property:** Each of the

spouses is entitled to the assets which comprise the community property, but neither is entitled to dispose of the assets independently, i.e., without the consent of the other spouse.

Legal entities, however, often own residential property as well.

B. Commercial Property

Commercial property is usually owned by private legal entities. Joint-stock companies (a.s.) and limited liability companies (s.r.o.) are the most common forms of legal entities used for the purpose of owning real estate (or for any entrepreneurial aim, for that matter) in the Czech Republic.

1. Limited Liability Company – s.r.o.

- a. Most widely used legal form for corporations.
- b. Highly flexible, with relatively few obligations.

a) Legal Entity

- a. A legal entity acts autonomously, represented by executive director(s). Subject to taxation independently of its members (shareholders).
- b. The rights and obligations of an s.r.o. exist autonomously from those of the shareholders and the executive directors.

b) Formation



- a. An s.r.o. is founded by way of conclusion of a Memorandum of Association or via a Foundation Deed in the case of a sole shareholder. It has to be notarized.
- b. Setting up an s.r.o. is uncomplicated and can be accomplished easily. Registration is done either directly by notaries or via the courts.
- c. Under Czech law, it is not mandatory to set up a supervisory board as one of the bodies of an s.r.o.

c) Costs of Formation

The estimated total notarial costs for the formation of a standard s.r.o. usually amount to approximately CZK 6,800 CZK (€250) (In the case of registered capital – CZK 100,000 (€3,700)) plus court costs, about approximately CZK 6,000 CZK (€220) and fees for legal counsel regarding the drawing up of the Foundation Deed or of the Memorandum of Association. Notarial costs are calculated based on the amount of the company's registered capital. The registration of an established company in the Commercial Register can be performed directly by a notary following the procurement of a

certificated notarial deed. In such a case, the total costs of the formation of an s.r.o. are a little lower.

d) Minimum Registered Capital

- a. The minimum registered capital required for an s.r.o. is 1 CZK. It is, however, recommended to set up a company with higher registered capital, which will serve to cover the company's initial expenses and to avoid having to declare bankruptcy due to lack of funds early on. It is thus recommended to set up a company with registered capital in the amount of at least CZK 100,000 (€3,700).
- b. At least 30% of each shareholder's monetary contribution to the registered capital must be paid to a special bank account before the company's registration in the Commercial Register. If the company's registered capital is lower than CZK 20.000, contributions



to the registered capital are not required to be paid to a special bank account but may be paid to a contribution administrator.

e) Limited Liability

- a. The shareholders of the entity are not personally liable for the company's debts. The shareholders' liability is joint and several and is limited by the extent of the shareholders' unpaid contributions to the registered capital registered in the Commercial Register at the time they are invited by the company's creditor to satisfy the company's debt.
- b. The limitation of liability arises once the s.r.o. has been registered in the Commercial Register.
- c. The company's statutory body is comprised of one or more executive directors.

The executive directors act in all matters on behalf of the company. The manner in which the

executive directors are to act on behalf of the company is also registered in the Commercial Register. The Foundation Deed and the Memorandum of Association may stipulate that the executive directors constitute a collective body.

- d. Any internal restrictions of the executive directors' powers are not effective against a third party. Under Czech law, a violation of these restrictions by an executive director will not affect the validity of a contract with a third party, but the s.r.o. may hold the executive director in question liable for damages.

2. Czech Joint-Stock Company – a.s.

- a. An a.s. (akciová společnost) is a legal entity in which the shareholders are not liable for the debts of the company during its existence.
- b. It is much more complicated to form and to operate than an s.r.o.



- c. Hence, the rules governing an a.s. are generally less flexible compared to the rules for forming a limited liability company.

a) Formation

- a. At least one founding shareholder is required; this may be either an individual or a legal entity.
- b. The minimum share capital is CZK 2,000,000 (EUR 80,000).
- c. The Articles of Association must be notarized and contain certain mandatory information.
- d. Application for registration in the Commercial Register is to be filed with the court with local jurisdiction (i.e., the place where the company is located).

Note: Previously, the founding shareholders had to pay a minimum contribution. In the case of cash contributions: each of the founders had to pay at least 30% of the

subscribed registered capital by the time of the submission of the proposal to the Commercial Register.

- e. Tax registration is to be carried out with the local tax authority.
- f. The company must establish a website containing the obligatory information concerning the company without undue delay after its registration into the Commercial Register

b) Structure – 2 options

- a. There are two options regarding the company's structure: (i) the monistic structure, (ii) the dualistic structure. Neither option is implemented in Czech law in their pure forms. The company may freely change its structure by changing its Articles of Association.
- b. The structure is typical in European countries such as Italy, France and Switzerland, and this structure is also used



- in European Companies (Societas Europaea).
- c. In a Czech Joint-Stock Company with a monistic structure, the Management board fills both the supervisory and executive roles and is the company's only corporate body. Members of the Management board are appointed by the General Meeting. Management board may also have only 1 sole member.
- d. The dualistic structure, which is also currently used in Germany, is the most common structure of corporate governance in a joint-stock company in the Czech Republic.
- e. A company with a dualistic structure has a Board of Directors and a Supervisory Board. The Board of Directors is the company's statutory (executive) body which is in charge of the company's business management. Nobody is authorized to instruct the Board of Directors as regards matters linked to business management. The Supervisory Board is the controlling corporate body supervising the performance of the Board of Directors and the undertakings of the company. Nobody is authorized to instruct the Supervisory Board in controlling matters regarding the Board of Directors.
- f. The General Meeting is the third body of the a.s. in both types of corporate structure. It consists of all company shareholders. Its most important rights consist of (i) electing new members of the Board of Directors in the dualistic structure if the Memorandum of Association does not delegate this right to the Supervisory Board; (ii) electing new members of the Management Board in the monistic structure; (iii) deciding on the distribution of profits and amendments to the Articles of



Association.

c) Liability

- a. Only the company is liable towards the company's creditors, not the shareholders.

Note: Persons acting on its behalf are liable for the obligations which arise before the company's incorporation in the Commercial Register. If there are more persons acting together, they are liable for such acting jointly and severally. The company can assume the effects of such acts no later than three months from its incorporation and then it is bound by such acts as if it was bound by them from the very beginning.

3. Other types of entities

There are two other types of Companies under Czech law, a Limited partnership company (k.s.) and an Unlimited partnership company (v.o.s.), these are, however, not often used in real estate transactions.

The same applies to private law associations that are not considered to be legal entities and where the liability of the members is unlimited.

VIII. Financing

- a) The usual method of financing real estate deals is by way of a bank loan/mortgage for at least a part of the purchase price. A bank generally insists on being provided with collateral before the loan is drawn.
- b) Usually, the buyer has to cover a certain portion of the price from their own sources. For large development projects, banks usually require a pledge on all possible claims which the buyer can gain in connection with the real estate.
- c) In connection with this, the buyer often has to present the seller with an irrevocable acceptance of loan financing by a reputable bank or show proof of sufficient funds before signing the purchase agreement.
- d) Normally, the mortgage/loan is provided for about 60%, up to 70%, of the purchase price.
- e) For special transactions such as large individual properties or real estate portfolios, a common alternative to a bank loan is the use of capital market products, for instance, bonds, receivables, or credit derivatives.

IX. Payments and Costs

- a) The costs and taxes are normally borne by the buyer. However, usually the seller has to bear the costs of deletion of old mortgages from the Land Registry.
- b) Usually, the purchase price is transferred to an escrow account maintained by a notary, a bank or an attorney-at-law, whereafter the money gets transferred to the seller following the successful registration of the transfer in the Land Registry.



- c) The tax on acquiring property was abolished. No notary or important registration fees are mandatory. The necessary official registration stamp is only EUR 100.

X. Examinations before closing

- a) The buyer is advised to check the title to the property for any potential or actual deficiencies and the financial condition of the seller as well.
- b) Commercial buyers should also check if there are any planning restrictions imposed upon the property, since a construction or alteration as well as change in use or the demolition of a building requires a building permit. The building project has to comply with the content of the local (or regional, as the case may be) development plans. Therefore, with regard to prospective plans of construction, the development and land use should be reviewed very carefully before the closing of the contract.
- c) In addition to this, environmental issues should be checked before closing too.
- d) A thorough check of the counterparty background has become necessary recently due to proliferation of various sanctions imposed by mainly the USA and EU.

Note: It is highly recommended to undertake a due diligence review before the closing of the contract.