NEW LAW ON CONVERSION OF RIGHT OF USE INTO OWNERSHIP OF CONSTRUCTION LAND WITH A FEE

JPM | JANKOVIĆ POPOVIĆ MITIĆ

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Author: Ivan Petrovic, Senior Lawyer
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On July 16, 2015, the National Assembly of the Republic of Serbia enacted the Law on Conversion of Right of Use into Ownership of Construction Land with a Fee. The main goal of this Law is to finally resolve the issue of anachronous right of use of construction land and, after more than fifty years, to institute the regime of private and public property when it comes to construction land, as the only right recognizable to all, particularly to foreign investors.

The agony of converting right of use into ownership with a fee has been ongoing since 2009, when the current Law on Planning and Construction was enacted. The provisions of this law which regulated conversion of right of use with a fee, specifically decrease of the conversion fee, were pronounced unconstitutional in 2012, which completely halted all procedures for issuing construction permits, since in the majority of cases the issuing of such permits had to be preceded by conversion. The end result of this legislative endeavor was a total standstill of the construction industry.

Apart from the decision of the Serbian Constitutional Court which placed the provision of the law decreasing the fee for conversion of the right of use of construction land into ownership by the cost of the capital (or assets) paid in the privatization procedure out of force, the total fiasco surrounding the conversion with a fee was aided by the viewpoints of the European Commission and certain foreign countries which were of the opinion that conversion violates the provisions of the regulations governing state aid, and that conversion affect the right to restitution.

Towards the end of 2013 the first drafts of the new law on planning and construction, regulating, inter alia, the issue of conversion, and specifying that the conversion fee would be 80% of the market value of the land, appeared in public. After sharp criticism during the public debate, the first drafts of the law were withdrawn, and the members of the team working on the draft of the law were all changed.

The new team preparing the draft law on planning and construction failed right from the start in dealing with the challenge of converting right of use into ownership with a fee, so a solution for the issue of conversion with a fee was missing from the amendments and supplements to the Law on Planning and Construction adopted in December 2014. The amendments and supplements specify that the issue of conversion with a fee will be governed by a separate law.

In March of 2015 the Ministry of Construction, Transport and Infrastructure began working on a draft of the law on conversion with a fee. After an extremely transparent and quite analytical procedure for preparing the draft, the Ministry submitted to the National Assembly a draft law intended to meet the completely opposed requests of foreign investors and requirements from the binding decision of the Serbian Constitutional Court, European Commission, Restitution Network and others. Apart from being a compromise between the opposed interests of certain social groups, the new law on conversion with a fee should also have a positive impact on the economic and financial system and spark investments into the Republic of Serbia.

In such "tense atmosphere" the proposed law on conversion indicates that the requests of the European Commission have been fully adopted, but also that the European Commission has accepted the previously adopted principle of "conversion before restitution" which gives conversion the advantage, meaning that persons holding the right to conversion can acquire right of ownership of construction land regardless of restitution requests concerning that same land. Moreover, most requests of organizations of foreign investors have been adopted, and most importantly, the acquired rights (specifically the right to build) of persons who had previously acquired the right of use (without the obligation to convert with a fee) have been protected.

The new Law on Conversion of Right of Use into Ownership of Construction Land with a Fee regulates the right and the conditions for conversion with a fee, the possibility of establishing lease rights to construction land, as well as some other matters (e.g. certain rules of procedure).

The persons that have to pay a fee to convert right of use into ownership are entities that have been privatized, that have acquired right of use in accordance with earlier regulations, socially-owned companies, entities that were established according to the succession agreement for former SFRY and entities whose position is determined by the law governing sports.

The conversion fee is specified as the market value of the land at the time of submitting the request for conversion. This legal solution was sharply criticized during the public debate on the draft law by the organizations of investors. By this imposed obligation to pay a fee equal to the market value of the land, those investors that have acquired the right to use construction land indirectly (by buying shares in the privatization, bankruptcy or enforcement procedure) and that have, de facto, already paid a certain sum for this right of use, are now placed in the unenviable position of having to pay the full market value for acquiring ownership rights.

This is coupled with the fact that before the Law on Planning and Construction came into force in 2009, holders of right of use had a right that was suitable for obtaining a construction permit, but after this Law came into force conversion of right of use into ownership (with or without a fee) became a prerequisite for obtaining a construction permit, since right of use was no longer a right that was suitable for obtaining a construction permit.

Thus by the imposition of the obligation to pay the full market price for the construction land, individuals have to pay the full price to acquire the right to build, which they had before conversion with a fee was introduced into the legal system in 2009.

On the other hand, the representatives of the Ministry defended the fee amount by citing the obligations imposed by the decision of the Constitutional Court and the requests of the European Commission relating to regulations on state aid. In essence, as the author hereof understands it, the decision of the Constitutional Court does not impose the position that the fee for conversion has to equal the full market value of the land. [1]

Moreover, the provisions on state aid control can also not be applied to the conversion fee, because the conversion fee does not constitute decreased income or potential expenditure by which a beneficiary of state aid is afforded a more favorable position compared to the competition. This is due to the fact that this income (income from the fee) would not even exist if conversion with a fee were not introduced into the Serbian legal system in 2009.

Unfortunately, the wording of the decision of the Constitutional Court uses the word "benefit" in relation to any decrease of the conversion fee, so the concept of decrease or "benefit" is retained in the new law as well. Such wording of the decision of the Constitutional Court, and therefore of other regulations as well, and the word "benefit" itself raises red flags in the European Commission which, after such a definition, has no problem qualifying a decrease of the conversion fee as state aid, even though it is not state aid and cannot be considered as such.

Therefore the Law on Conversion applies a solomonic solution to this conflict of viewpoints and opinions between the European Commission and the organizations of foreign investors, adopting the concept of payment of the full market value of the land as a conversion fee, with the possibility of decreasing this fee on three grounds.

First, the conversion fee can be decreased for land in the territory of local self-government units determined to be insufficiently developed and with an extremely low standard of living or high unemployment rate, in compliance with the Law on State Aid Control.

Second, if the holder of the right of use incurred costs for acquiring the right of use, the conversion fee is decreased if the applicant submits a court decision determining that the applicant incurred costs for the right of use. [2]

Third, if the land undergoing conversion is developed construction land, the applicant is not obligated to pay the fee for conversion of the land which is needed for regular use of the facilities.

Such a concept for decreasing the conversion fee, particularly in the case of developed land, indicates that the legislator's intent was to make concessions to investors through such decrease. Unfortunately, such decreases do not resolve the issue of conversion of undeveloped construction land. Despite the obvious good will to decrease the conversion fee, there are no grounds for decrease of the conversion fee for undeveloped construction land.

In the interest of protecting the acquired rights of the persons holding the right of use to undeveloped land, the Law on Conversion specifies the option of converting use into long-term lease. At the same time the Law specifies that a long-term lease constitutes valid grounds for obtaining a construction permit in compliance with the Law on Planning and Construction.

The lease would be concluded for a period of 99 years, and the rent for these 99 years would be equal to the market value of the land being converted. After constructing the building or facility the holder of the lease right would be entitled to convert the right of lease into right of ownership, and this would include the right to a decrease on the grounds of the constructed building or facility.

By such a solution the legislator confirmed its viewpoint that the primary goal with regard to conversion is development, and not collection of the conversion fee. On one hand, this will stimulate construction, and on the other it will protect the acquired rights of investors.

Looking at the norms that substantively regulate conversion of the right of use into ownership, one can conclude that the proposed solutions are a good basis for further development of the institute of conversion. The holders of the right to use construction land will be able to carry out the conversion at minimum cost, presuming they construct the necessary buildings on the land, that is put the land to its intended purpose.

On the other hand, investors who acquired the right of use through privatization, without the intention to build on the land, but instead to transfer the right of use (i.e. right to build) to third parties by semi-legal means and to collect the value of the land, will be prevented from doing so, since they will have to convert the right of use into right of ownership and pay the conversion fee equal to the market value of the land.

On the other hand, the law has in many matters remained incomplete and imprecise, and in certain segments absolutely unclear. Such provisions obviously resulted from the fact that the law was written and enacted in a summary procedure and was therefore not appropriately reworked and consolidated.

I will list two provisions as examples of the impreciseness and incompleteness. First, it is unclear who determines the market value of the land. According to the law, the market value of the land is determined by the local self-government unit in compliance with the act on determining the average price per square meter for the appropriate real estate in zones for the purpose of assessing property tax.

This provision and the manner of its application create vagueness regarding the principle and method for determining the market value of the land. Moreover, certain individuals can exercise the right to a decrease if they submit a court decision stating that they incurred costs for acquiring the right of use.

Such a provision is imprecise, due to the fact that it is unclear which type of decision or procedure would be necessary to determine the existence of acquisition costs. Moreover, there is also the issue of who would be the opposing party in such procedures, and which costs can be considered costs of acquiring the right of use.

In certain segments the Law on Conversion contradicts itself. The contradiction between the norms is best seen in procedural provisions. Namely, Article 4 of the Law on Conversion specifies the obligation of the competent body of the local self-government unit to obtain the necessary evidence (real estate folio in the land register and information on the location), while Article 10 specifies which documents have to be submitted with the application under pain of rejection of the application, meaning that the applicant already has to submit the real estate folio with the application.

Regarding lease of construction land, the Law is incomplete, namely it invokes the provisions of the Law on Planning and Construction relating to long-term lease of construction land. On the other hand, the amendments and supplements of the Law on Planning and Construction from 2014 have erased the provisions regulating long-term lease of construction land, meaning that long-term lease, in the form and context specified by the Law on Conversion, does not exist.

The new Law on Conversion is a good beginning. The fact that the Ministry as lawmaker has demonstrated maximum transparency in preparing the law, and willingness to adopt compromises, has resulted in several excellent new ideas in the law, particularly regarding long-term lease of construction land. Also commendable is the fact that the Ministry has through its legal solutions confirmed its interest in advancing construction and development, instead of filling the budget through collection of conversion fees.

However, just like after the enactment of any other law, the question of the application of the new Law on Conversion remains, accompanied by the fact that inconsistencies and occasional vagueness in the new Law on Conversion can only contribute to the improper application of this Law. Certain provisions of the Law will in any case have to be subject to authentic interpretation, so that the local self-governments, and even the courts, can apply the Law on Conversion in accordance with the legislator's intent.

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[1] Decision of the Constitutional Court – the Constitutional Court found that "the legislator in determining the fees for acquiring right of use of construction land, in the manner specified by the disputed provision of Article 103 para. 1 of the Law, has envisaged benefits for privatized companies and buyers of assets or parts of assets in privatization, bankruptcy or enforcement procedures, in calculating the amount of the fee for conversion of the right of use held by these persons over the construction land into right of ownership. This benefit, depending on whether the price of the capital or assets paid during the sales procedure was higher or lower than the market value of the construction land for which conversion is sought, is manifested in such a manner that the holders of right of use to the construction land have the option of achieving conversion of this right with a lower fee or without a fee." The Constitutional Court goes on to state that "public interest in specifying the disputed benefit must be founded on objective and reasonable grounds, that is on objective indicators based on which the legislator assessed that the situation the privatized companies and buyers of assets or parts of assets in privatization, bankruptcy or enforcement proceedings are in requires and justifies the granting of benefits to these persons in the form of the disputed manner of calculation of the fee for conversion."
It follows from these parts of the decision of the Constitutional Court that the market value of the land must be the basis for calculation of the conversion fee, and that the decrease of the fee can be specified so as to be in the public interest, that is to afford everyone an equal "benefit."

[2] This provision is not at all clear and its further application will have to be developed in practice.

JPM JANKOVIĆ POPOVIĆ MITIĆ
NBGP Apartments, 6 Vladimira Popovića street
11070 Belgrade
Tel: +381 11 207-6850, Fax: +381 11 207-6899
E-mail: office@jpm.rs, Online: www.jpm.rs

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