

in re

Transactions with Real Estate: New Legal Regime



by Taras V. DUMYCH

The aim of the present article is to analyse the novelties within the legal regime of real estate transactions introduced by the *Civil Code of Ukraine* (the “Code”) which was enacted by the *Verkhovna Rada* (Ukrainian Parliament) on 16 January 2003 and came into force on 1 January 2004.

The Code has introduced a large number of new “rules of the game” based on which parties to different types of real estate transactions will need to structure their relationships. Many of these new rules are considered as positive and create favourable and fair conditions for the development of a civilized real estate market in Ukraine. On the other hand, some rules under the Code, in order not to negatively influence the legal regime for real estate transactions, could be either amended or supplemented with other laws precluding the negative effect of these rules.

Nevertheless, it is important to bear in mind that the application of the rules of the Code without the rules of other acts of parliament and the government currently in force, or which need to be adopted in the future, may not be fruitful. In this regard, the provisions of the *Land Code of 25 October 2001* (“*Land Code*”), the *Mortgages Act of Ukraine of 5 June 2003* (“*Mortgage Act*”), the *State Registration of Proprietary Rights to Real Property and*

Taras V. Dumych is an associate with B.C. Toms & Co (Kiev)

Their Limitations Act of Ukraine of 1 July 2004 (“*State Registration Act*”), the *Commercial Code of 16 January 2003* and others, will need to be referred to when applying the provisions of the Code.

What is real estate?

The Code has, for the first time, introduced a legal definition of real estate (immovable property): land plots and constructions located on land plots, relocation of which is impossible without reducing the value and changing the purpose of the use of such constructions. This real property regime may also be extended by the law to include aircraft, vessels and space facilities. The Code establishes that the integral property complex¹ of an enterprise is real estate and that it can be subject to sale, purchase, pledge, lease and other transactions.

In addition, according to Article 381 of the Code, a farmstead, which is a land plot together with a residential house, associated buildings, underground and surface communications and perennials can also be ascribed as being real estate. In connection with a farmstead, the Code further provides that in the event of the alienation of the residential house the whole farmstead is considered to be alienated, unless otherwise provided by the sale agreement or law.

New types of real estate agreements

Alongside the legal provisions concerning the “classical” types of agreements on real estate such as purchase and sale contracts, the Code has introduced some relatively new forms of agreement for the Ukrainian legal system which may be applicable to real estate transactions, in particular, the rent agreement and the management agreement.

Pursuant to Article 731 of the Code, under a rent agreement, one party (the rent recipient) transfers to the other party (the rent payer) a property into

the rent payer’s ownership, and the rent payer is obliged from time to time to pay rent to the recipient in monetary or other agreed form. On the other hand, a management agreement is defined by Article 1029 of the Code as an agreement through which one party (the “settler”) transfers the management of the property to another party (the “manager”) for a certain period of time. The manager is obliged to manage the property transferred under such agreement for the benefit of the settler or for the benefit of a third party (the “beneficiary”) as determined by the settler.

The core difference between the rent and the management agreement is that under the rent agreement, the ownership (title) to the property passes from the recipient to the rent payer, whereas under the management agreement, the title to the property remains with the settler of the management. Consequently, the legal nature of the management agreement under Ukrainian law is similar to trusts and beneficial ownership under common law. Article 316 of the Code supports this argument providing that trust ownership is a special type of ownership right, which arises by law or by a management agreement on property.

Forms of real estate agreements

It should be emphasized that, according to Article 657 of the Code, an agreement for the sale and purchase of a land plot, an integral property complex, a residential house (apartment) or other real property, must be executed in writing, certified by a notary and registered at a state registry. Unlike the old *Civil Code of 1963*, the new Code does not establish any exceptions allowing legal entities to validly execute real estate purchase agreements without notarisation.

Furthermore, if the subject of a management agreement or rent agreement is real property then, pursuant to the Code, these agreements must also

be certified by a notary and duly registered at a state registry (as discussed below in this article).

The Code has also established a new requirement applicable to real estate leases. According to Article 793 of the Code, leases must be in writing, and if the lease agreement is executed for a term of one year or more, such lease agreement must also be notarized. This requirement has created a controversial situation resulting in a great deal of discussion within the real estate business and law practitioners' societies. On one hand, notarization of a lease agreement may be considered a step that provides additional legal protection to the parties of such lease agreement. On the other hand, when notarizing agreements, including lease agreements, a state duty (fee) in the amount of 1% of the agreement's value is levied and a lease of a sizeable space with a high rent over a long term can result in the imposition of a significant, burdensome state duty.

As the result, players in the real estate market have begun considering methods to avoid the burdensome state duty requirement. One suggested method has been to conclude a series of short-term leases of less than one year covering a period of several years. Although this tactic may be useful (and court practice has not so far proved otherwise), it is definitely not helpful in developing a stable real estate business or the real estate leasing industry in general. Perhaps the best way for the government to solve the problem is to either significantly decrease the current 1% state duty or to introduce a fixed fee of a reasonable amount for notarization of lease agreements covering one or more years. Either suggestion would not only positively affect the stability of the real estate leasing business but would also be an efficient measure towards reducing the shadow economy in this sector.

State registration of the real estate agreements

Article 210 of the Code establishes a general rule that an agreement shall be registered only in cases required by law. An agreement subject by law to state registration is only considered to be concluded (valid) from the time of registration.

The Code requires the following real estate agreements to be registered: sale and purchase agreements, rent agreements, management agreements, pledge agreements and lease agreements for a term of one or more years.

State registration procedures for these agreements are governed by the *Resolution of the Cabinet of Ministers of Ukraine of 26 May 2004 On Approval of the Temporary Procedure for State Registration of Agreements* ("Temporary Registration Procedure"). This *Temporary Registration Procedure* provides that state registration of an agreement is performed by the notary who notarized such agreement, who must submit the necessary information concerning the agreement to the State Registry of Agreements computer system. If the notary does not have access to the computer system, such notary must send one copy of the agreement to the State Registry on the same day when the agreement is notarized.

Furthermore, the *Mortgage Act* also requires mortgage agreements to be registered. For the purpose of establishing a procedure for registration of mortgage agreements, the Cabinet of Ministers of Ukraine adopted the *Resolution On the Temporary Procedure for the State Registration of Mortgages* ("Mortgage Registration Procedure"). Under the *Mortgage Registration Procedure*, the State Registry of Mortgagees, to be created under the Ukrainian Justice Ministry, is the public mortgage registry.

State registration of title to real estate

According to Article 334 paragraph 4 of the Code, if an agreement on alienation of property² must be registered, then a purchaser acquires title to such property from the moment of registration. The *State Registration Act* governs registration of title to real estate. Pursuant to this Act, registration of title to all real estate is to be carried out by a new State Registry of Rights to Real Estate and their Limitations ("State Registry of Rights") to be created within the State Committee of Ukraine for Land Resources.

In addition to title (ownership rights), the following rights to real estate must also be registered with the State Registry of Rights: (a) proprietary rights,

including *inter alia*, right of possession, servitudes and rights of use of real estate with a term exceeding one year, and (b) limitations of proprietary rights arising, for example, out of mortgages, court injunctions and decisions, etc.

It should be noted that according to the *State Registration Act*, its provisions are applicable not only to the registration of title, proprietary rights and their limitations but also to the registration of agreements on real estate, by, in fact, creating a so-called "one window registration" procedure for combining registration of title, proprietary rights and their limitations on the one hand and registration of agreements on real estate on the other hand. It may be argued, in this case, that this situation has both positive and negative effects. As established by the *State Registration Act* "one window registration" may be considered a positive effect. However, one negative effect is that the timing of the registration procedure creates a situation where a real estate purchaser would not be certain of the status of title to the purchased real estate until the sale-purchase agreement has been registered. On the other hand, under the above-mentioned *Temporary Registration Procedure* it is possible to check whether there are any conflicting agreements or rights concerning the property in question, before the conclusion of an agreement concerning the property.

In this case it is essential that all potential problems concerning the registration of title to, and agreements with, real estate under currently existing differing systems are successfully resolved and the positive feature of registration procedures existing under the *State Registration Act*, *Temporary Registration Procedure* and *Mortgage Registration Procedure* are implemented in practice and applied. ■

¹ *Lease of State and Communal Property Act of Ukraine of 10 April 1992* defines an integral property complex as a business entity that produces an end product (whether goods or services) together with a land plot on which such a business entity is located, with an autonomous engineering communications and electricity supply system.

² In this case, by using the term "property", the Code refers to both movable and immovable property.