



HAN KUN LAW OFFICES

Legal Commentary



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Overview of the New Regulations for Private Schools

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On January 18, 2017, the State Council officially promulgated the *Several Opinions of the State Council on Encouraging Non-governmental Sectors to Run Schools and Promoting the Healthy Development of Non-governmental Education* (Guo Fa [2016] No. 81) (the "**Opinions**"). On the same day, the Ministry of Education published two regulations regarding private schools on its official website, namely the *Notice of the Ministry of Education and other Four Departments on the Issuance of Detailed Rules for the Implementation of Private Schools Classification Registration* (Jiao Fa [2016] No. 19) (the "**Registration Rules**") and the *Notice of the Ministry of Education, the Ministry of Human Resources and Social Security and the State Administration for Industry and Commerce on the Issuance of Detailed Rules for the Implementation of the Supervision and Management of For-Profit Private Schools* (Jiao Fa [2016] No. 20) (the "**Management Rules**", which, together with the Opinions and the Registration Rules, are referred to as the "**Regulations**"). The Regulations mentioned above are regarded as key rules in the private education industry and supplement the *Private Education Promotion Law of the PRC* (revised in 2016)¹ (the "**Promotion Law**"), as amended on November 7, 2016. The Regulations will help to promote private school classification administration reforms and facilitate the implementation of related preferential policies. This article will provide a brief overview of the Regulations based upon relevant provisions of the Promotion Law.

Approval and Registration

a. Approvals / School Licenses

Based on the Promotion Law, the Registration Rules further clarify that school licenses must

¹ The Promotion Law will become effective from September 1, 2017. For comments on the Promotion Law, please refer to a previous newsletter entitled Comments on the Revisions to the Private Education Promotion Law (Chinese).
(<http://www.hankunlaw.com/downloadfile/newsAndInsights/5d6ea3265feb360cd30ab4426cdb5481.pdf>)

be obtained to set up both non-profit and for-profit private schools. The Management Rules further specify that establishing for-profit private education institutions is subject to the same requirements applicable to establishing for-profit private schools. We understand this to mean that for-profit private educational institutions also need to obtain school licenses in order to be established. If this is the case, for-profit private educational institutions that have registered with AIC as companies will be required apply to obtain school licenses. We will monitor the latest regulatory developments with respect to this issue.

b. Classification Registration

The Registration Rules set forth different rules for the registration of newly established non-profit private schools and for-profit private schools, respectively.

- i. Non-profit private schools: Non-profit private schools are to be registered as private non-enterprise units in accordance with the *Interim Regulations on the Registration and Administration of Non-governmental Non-enterprise Units* (the “**Interim Regulations**”) or registered as public institutions in accordance with the *Interim Rules on the Registration and Administration of Public Institutions* (the “**Interim Rules**”). The Interim Regulations will be replaced by the *Regulations on the Registration and Administration of Social Services Institutions* (the “**Administration Regulations**”), which has been issued for public comment by the Ministry of Civil Affairs. After the Administration Regulations come into effect, private non-enterprise units will be regarded as “social service institutions.”² According to the Interim Rules, “public institutions” refer to social service organizations that are organized by state organs or other organizations by using state assets. They are founded for social welfare purposes and mainly carry out education, science and technology, culture and public health activities, etc. According to Article 2 of the Promotion Law³, public institution-type private schools refer to educational institutions set up by non-state institutions that utilize state assets (excluding state fiscal funds). Thus, the difference between public institution-type private schools and the private non-enterprise unit private schools is that the latter are funded from non-state assets⁴.

² <http://www.mca.gov.cn/article/zwgk/tzl/201605/20160500000664.shtml>

³ According to Article 2 of the Promotion Law, this law shall be applicable to activities conducted by public organizations or individuals, other than state organs, to establish and run schools and other educational institutions with non-governmental financial funds which are geared towards the needs of society. In cases in which no provisions of this Law are applicable, the provisions in the Education Law and other laws concerning education shall apply.

⁴ According to Article 2 of the Interim Regulations, publicly-run non-enterprise units referred to herein mean social organizations founded by enterprise institutions, social groups and other social forces and individual citizens with non-state-owned assets that engage non-profit social services.

According to Article 5 of the Interim Regulations, the publicly-run non-enterprise units must have legitimate properties matching with its business operations, of which the percentage of the non-state-owned assets cannot be less than two-thirds. The start-up capital of the units must meet the minimum standards applicable to the industry.

With respect to the level of the registration authority, non-profit private universities that provide education at the undergraduate level or above are required to be registered with the relevant departments at the provincial level, while non-profit private schools that provide education at the junior college level or below should be registered with the relevant department at the county level or above as determined by the provincial government.

- ii. For-profit private schools: The Registration Rules only provide that for-profit private schools that have obtained formal approval for establishment should carry out registration with competent AIC in accordance with the laws, but they do not explicitly provide whether such schools must register solely as companies (limited liability companies or limited liability companies), or may be registered as another type of commercial entity. We understand the general practice in this area to be that such schools should be registered as companies.

With respect to the classified registration of existing private schools, the Registration Rules only reiterate the principles provided by the *Decision of National People's Congress Standing Committee on the Amendment of the Private Education Promotion Law of PRC*. That is, where existing private schools choose to register as non-profit private schools, they should revise the school's articles of association and re-register with the government to continue operating. Where the existing private schools choose to register as for-profit private schools, they should carry out financial settlement, apply to the relevant departments below the provincial level to ascertain the ownership of land, school buildings, profits and other school property and pay related taxes, apply for a new school license and re-register with the government to continue operating. In addition, the government at provincial level should formulate the rules related to the amendment of private school registration types in accordance with relevant state rules and based upon actual local conditions.

Support Policies

One highlight of the Opinions is the clarification of the support policies for private schools. The support policies mainly include:

a. Financial support

The government's financial support for private education is required to be included in its budget. Local governments at all levels are to establish and improve the government subsidies system and specify projects, targets, standards and purposes of the subsidies. The government will improve the standards and procedures for services procurement, establish performance evaluation systems, and formulate specific policies and measures related to the purchase of degree courses, curriculum materials, scientific research achievements, vocational training

courses and policy consultation services from private schools. The local governments may establish private education development foundations in reference to state rules applicable to foundation management, support to establish corresponding foundations and organize various types of activities that will help to develop private education.

Han Kun Comments: The above policies provide a basis for governments at all levels to extend financial support to private schools in which they have no ownership interest.

b. Tax preferences

Real property and land that enterprises use to operate all types of schools and kindergartens are exempt from property tax and urban land use tax. Enterprise donations to support education is eligible for an income tax deduction of up to 12% of total annual profits. Individual donations for education may also be deducted when calculating the individual's taxable income. Non-profit private schools are subject to tax treatment equal to that of public schools. This means that, following tax-exempt certification, non-profit private schools can operate as tax-exempt entities in accordance with the tax laws, and their non-profit income will be exempt from enterprise income taxes. In addition, private schools will be subject to the same electricity, water, gas and heat price as public schools.

Han Kun Comments: Relevant tax matters under the above policies still need to be further clarified. For example, when private schools make charitable donations, can they be considered as charitable organizations in accordance with the Charity Law? As for non-profit private schools, can they be directly regarded as non-profit organizations as defined in Article 26 of the Enterprise Income Tax Law?

c. Land policy

Land for constructing private schools is managed as science and education-use land. Non-profit private schools will enjoy the same policy as that applicable to public schools and can acquire land by way of assignment. Land will be transferred to for-profit private schools according to corresponding state policy. Where there is only one purchaser bidding for a land parcel, the land may be assigned to the purchaser in accordance with an agreement. Afterwards, if the purchaser changes the use purpose of all or part of the land, the government will reclaim the purpose-changed land and re-sell the land to a purchaser at a new market price according to law.

Han Kun Comments: In addition to acquiring land through bid invitation, auctioning and listing, for-profit private schools may also acquire land pursuant to an agreement. This provides an opportunity for for-profit private schools to acquire land at a below-market prices. However, if the land user subsequently changes the purpose of the land purchased at a lower price, there is a risk of the government reclaiming such land.

d. Broadening financing channels

Financial institutions are encouraged to develop financial products suitable for private schools to the extent the risks are controllable. Financial institutions should explore business methods of providing loans to private schools as pledged by the schools' operating income and intellectual property and aim to provide the schools with diversified financial services including bank loans, trusts and financial leases. Various societal forces are encouraged to make donations to non-profit private schools.

Han Kun Comments: It is noteworthy that, according to the Management Rules, for-profit private schools are prohibited from mortgaging their teaching facilities for loans or guarantees. The profits of the business operations of the schools are to be allocated after annual financial settlement.

e. Equal Student Subsidy Policy

Private school students will enjoy the same student subsidy policies as those applicable to public schools, such as policies regarding student loans and scholarships. Governments at all levels should establish and improve the support system for private school student loans business and increase the proportion of financially-disadvantaged students that are qualified to receive financial assistance in private schools. Private schools should establish a sound scholarship assessment and grant program, and should extract no less than 5% from the tuition revenues to reward and fund students. The government should implement preferential policies for education-related donations and encourage and guide enterprises and public institutions, social organizations and individuals to provide scholarships to private schools.

Han Kun Comments: Private schools should extract no less than 5% from the tuition revenue to provide scholarships, which will be deducted from allocable school profits.

Corporate Governance of Schools

According to Article 16 of the Management Rules, for-profit private schools are to set up six internal organizations, which are the board of directors, supervisors (or board of supervisors), administrative department, party organization, faculty congress and trade unions. The following highlights should be noted with respect to these organizations:

a. Board of Directors

According to Article 16 of the Management Rules, for-profit private schools are to establish a board of directors. Therefore, we understand that the Company Law provision that allows a company to have an executive director rather than a board of directors does not apply in the case of for-profit private schools. Also, pursuant to Article 44 of the Promotion Law, the quorum of a private school board of directors can be no fewer than five persons, while the

board quorum of a limited liability Company under the Company Law must be at least three members.

In line with Article 22 of the Promotion Law, the Management Rules specify that the board, rather than the shareholders' meeting or investors, is the highest decision-making body of for-profit private schools. If a for-profit private school intends to carry out a division, merger, termination or other major changes, it should initially seek the approval of its board before submitting an application to the examination and approval authority for review and approval. However, according to the Company Law, the decision-making body with similar roles in a company is the board of shareholders (or shareholders' meeting) of the company. Therefore, in case of the occurrence of any of the above events, we recommend incorporated for-profit private schools to seek approval of both the board of directors and the board of shareholders (or shareholders' meeting).

b. Supervisors (Board of Supervisors)

The Promotion Law has no provisions regarding supervisors (board of supervisors). However, the Management Rules provide detailed rules with respect to the supervisors (board of supervisors). According to the Management Rules, faculty representatives must make up at least 1/3 of the board of supervisors of for-profit private schools, and the board of supervisors should have party leadership organization members. However, the Management Rules do not provide that, if a school only appoints one or two supervisors⁵ but does not establish a board of supervisors, whether the supervisors should be faculty representatives, party leadership organization members or other specified persons.

The Management Rules also set forth that a natural person cannot serve as a member on the board of directors and the board of supervisors of a for-profit private school at the same time. In addition, in accordance with Article 51 of the Company Law, a senior officer of a company cannot simultaneously serve as a supervisor (this includes the manager, deputy manager, chief financial officer, board secretary in case of a listed company and other persons designated by the articles of association of the company). This provision applies to for-profit private schools established in corporate form.

c. Principals

The Promotion Law provides that the principal of a private school is in charge of teaching activities and school administration, and is appointed by the school's council or board of directors. The Opinions further clarify that private school principals should be familiar with the education industry and related laws and regulations, have five years or more of school

⁵ According to Article 51 of the Company Law, A large-scale limited liability company shall have a board of supervisors, which shall be composed of not fewer than 3 members. A small-scale limited liability company with only a few shareholders may have one or two executive directors without establishing a board of directors.

management experience, and have good personal credit.

The Opinions also provide for nepotism avoidance measures for key school management positions. However, the Opinions fail to explain how these measures apply between private school founders / investors and key management personnel or between the key management positions.

Standardizing school operations

The Management Rules provides detailed rules with respect to the organizational structure, teaching activities, financial assets and information disclosure of for-profit private schools and specifies punishment for violations. The Management Rules also provide for the “school founder blacklist” system. According to Article 48 of the Management Rules, under any of the following circumstances, the founder of for-profit private schools shall be put onto the blacklist and shall be prohibited from establishing or participating in the establishment of other for-profit private schools:

- i. The corporate property rights of the school are not fully protected.
- ii. The for-profit private school was put onto the list of enterprises with abnormal operations or the list of enterprises with serious legal violations or dishonest conduct.
- iii. School operating conditions are not up to standard.
- iv. Failed in the annual review in the most recent two years.
- v. Other circumstances prescribed by laws and regulations.

It is believed that the “school founder blacklist” system will restrict the subsequent investment activities of those that have been placed on the list.

Strengthening Party Leadership

In addition to specifying the establishment and functions of the general decision-making and management organizations of private schools, the Regulations also require the strengthening of the party in private schools. According to the Regulations, the party organization is the “political core ... which should be responsible for directing, guaranteeing and supervising decision-making on matters with respect to the aim of the school operations and the major interests of teachers and students.”

- i. All schools should have party organization coverage⁶. When applying to establish private schools, in addition to the materials required by the Promotion Law and other laws and

⁶ Article 3 of the Opinions.

regulations, the applicant should also submit school party building-related materials⁷.

- ii. In private universities, government commissioned-supervisors must be the person in charge of the party organization⁸. According to Article 25 of *Several Provisions on the Administration of Non-publicly Funded Universities*, a commissioned supervisor refers to the person delegated by the provincial education department to the private universities in accordance with the relevant state provisions, whose responsibilities are to supervise the universities' implementation of relevant laws, regulations and policies. However, it is awaiting to be further clarified whether the person-in-charge of the party organization in private universities must be the commissioned supervisor, or whether the school will initially appoint the person-in-charge of the party organization and propose to the provincial education department for him to be designated as a commissioned supervisor. If it is the former case, it would be difficult for the founder/shareholders' committee representative of the private university to appoint the person-in-charge of the university party organization.
- iii. Actively promoting the system of "cross appointment of party members between school and party organizations," means that party organization members⁹ may simultaneously hold posts in decision-making and administrative bodies. Principals and deputy principals who are party members can also have seats in the party leadership organization pursuant to relevant party articles. The board of supervisors should have party leadership organization members¹⁰.
- iv. Local governments are required to consider school party organization building and the party's leadership as important factors in the annual inspection of private schools¹¹.

⁷ Article 5 of the Registration Rules.

⁸ Article 3 of the Opinions.

⁹ Article 20 of the Management Rules further clarify that "the secretary of the party organization shall be appointed to the board of directors or administrative organs through legal procedures".

¹⁰ Article 19 of the Opinions.

¹¹ Article 3 of the Opinions.

● **Important Announcement**

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