



Art and cultural property

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Welcome to the latest issue of our "Art law - recent developments" newsletter in which we discuss legal issues currently affecting the global art community.

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Supervision of dealers in precious metals and stones – A new regime in Hong Kong

Introduction

Hong Kong is a member of the Financial Action Task Force ("**FATF**"). To implement the latest FATF Standards, the Hong Kong Legislative Council recently passed a bill to amend the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (as amended, the "**Ordinance**"). The amendment bill was gazetted on 16th December 2022.

As a result of the amendments, a new regulatory regime (the "**Regime**") in respect of dealers in precious metals and stones ("**DPMS**") came into force on 1 April 2023. This article provides an

overview of the Regime for dealers, jewellery lovers and other readers who are interested in knowing more about the Hong Kong precious metals and stones industry.

Scope of the Regime

The Regime is administered by the Hong Kong Customs and Excise Department ("**C&ED**"). The Regime requires certain local DPMS to be registered with the C&ED. Non-local DPMS are not required to register with the C&ED but are nevertheless regulated, albeit to much a lesser degree (for example, they need to report certain cash transactions conducted in Hong Kong (discussed separately below)).

A person will be considered as dealing in precious metals and stones if the person carries on any of the following activities by way of business:

- (a) trading in¹, importing or exporting precious metals, precious stones or precious products;
- (b) manufacturing, refining or carrying out any value-adding work on precious metals, precious stones or precious products;
- (c) issuing, redeeming or trading in precious-asset-backed instruments; or
- (d) acting as an intermediary in respect of any of the activities in (a), (b) or (c) above.²

The assets referred to above are defined in the Ordinance as follows:

- (i) **Precious metal** means gold, silver, platinum, iridium, osmium, palladium, rhodium or ruthenium, in a manufactured or unmanufactured state;³
- (ii) **Precious stone** means diamond, sapphire, ruby, emerald, jade or pearl, whether natural or otherwise;⁴
- (iii) **Precious product**⁵ means any jewellery or watch made up of, containing or having attached to it, any precious metal or precious stone, or both; and
- (iv) **Precious-asset-backed instruments** means any certificate or instrument backed by one or more of the assets defined in (i) to (iii) above that entitles the holder to such assets (in whole or in part) but excludes virtual assets and various investment products regulated under the Securities and Futures Ordinance (Cap. 571).

The Regime does not apply to:

- the Hong Kong Government;
- certain financial institutions (i.e. licensed corporations regulated by the Securities and Futures Commission, authorised insurers, licensed insurance brokers, licensed insurance agents, stored value facility licensees, and system operators and settlement institutions of a designated retail payment system) which carry on a precious metals and stones business that is ancillary to their main businesses;

- banks; or
- licensed pawnbrokers.

Local DPMS: Two-tier registration

Whether a business needs to be registered with the C&ED will depend on the type of transactions that the DPMS is carrying out. In the course of carrying on a precious metals and stones business, if the business enters into any transaction involving payment or payments made or received in Hong Kong, which:

- does not exceed HK\$120,000, whether in cash or non-cash, then the business will not be subject to any registration requirement;
- is equal to or exceeds HK\$120,000 and the payment is made in a payment method or payment methods **which does not or do not involve cash payment**, then the transaction is known as a "**Specified Transaction**" and the business will be subject to the registration requirement; or
- is equal to or exceeds HK\$120,000 and the payment or payments is/are made **in cash**, then the transaction is a "**Specified Cash Transaction**" and the business will be subject to the registration requirement.



In determining the amount of any particular transaction, payments that are linked or appeared to be linked in relation to the execution of a single transaction will be aggregated. Whether transactions are linked will depend on the circumstances, for example, a single buyer purchasing several precious metals and stones at the same time but with separate invoices or a group of buyers purchasing precious metals and stones at the same time albeit

¹ The C&ED clarified this to mean "selling, offering for sale, purchasing, offering to purchase or possessing for the purpose of sale".

² Logistic service businesses are exempted.

³ The C&ED clarified that this includes silver coins, gold bullions and gold statues.

⁴ The C&ED clarified that this includes rough diamonds, lab grown sapphires and jade statues.

⁵ The C&ED clarified that, other than jewellery and watches, products containing or having attached to it, only small amounts of precious metals or stones, or both, e.g. medical devices, industrial equipment, electronic products, food and beverages, stationery, etc., are not covered by the definition of "precious products".

with a clear indication that the buyers are acting on behalf of each other, may be considered to be linked. The C&ED clarified that mixed payments in cash and in credit should be viewed separately to determine whether any registration is required, even if the two payments relate to the same transaction.⁶

In order for a DPMS to carry out Specified Transactions, it must be registered as a "**Category A registrant**". Similarly, in order for a DPMS to carry out Specified Cash Transactions (regardless of whether Specified Transactions are also carried out), it must be registered as a "**Category B registrant**". If a business is unsure about whether it will carry out a Specified Cash Transaction in Hong Kong, the prudent view is that a Category B registration should be made.

A summary of the registration requirements is set out in the table below:

	Non-cash payment less than HK\$120,000	Non-cash payment equal to or more than HK\$120,000
Cash payment less than HK\$120,000	No need to register, even when the aggregate of both types of payments exceeds HK\$120,000	Category A DPMS
Cash payment equal to or more than HK\$120,000	Category B DPMS	Category B DPMS

The differences between a Category A DPMS and a Category B DPMS lie in the registration procedures, the standards expected of the registrant and the ongoing obligations applicable to the registrant.

The Category A DPMS registration process and ongoing obligations are relatively simple and light-touch. For example:

- only basic information, supporting documents and a simple declaration that the business is for lawful purposes are required;
- the consent of every occupant of all domestic premises or mixed commercial and residential premises will be required if such premises will be used for having customer meeting, administration of business affairs, carrying out transactions or storing records and documents;
- the Commissioner of the C&ED (the "**Commissioner**") may impose new, and amend or remove previously imposed, registration conditions;
- registration remains valid as long as the registrant duly pays the annual fee⁷ and complies

with the registration conditions and the statutory requirements under the Ordinance;

- a Category A DPMS has a notification obligation towards the Commissioner upon certain changes to its business; and
- the certificate of registration and (if any) branch certificates must be displayed in a conspicuous place at the principal place of business or the relevant branch (as the case may be). If the business is conducted online, then the relevant QR Code or registration number must be displayed on the online platform.

As it relates to a Category B DPMS:

- the applicant and his/her/its ultimate owner must satisfy the Commissioner that he/she/it is a fit and proper person to carry on the precious metals and stones business;
- when determining whether the applicant is a fit and proper person, the Commissioner will consider factors such as whether the person has been convicted of any money-laundering related

⁶ For example, a transaction with HK\$10,000 in cash and HK\$10,000 in credit will not subject the business to registration.

⁷ HK\$195.

offences, is an undischarged bankrupt or, if a corporation, is in liquidation;

- there must be in place an effective anti-money laundering and counter-terrorist financing ("**AML/CTF**") system, which must be submitted as part of the application;
- the applicant must employ and appoint a compliance officer (to implement effective AML/CTF policies), and a money laundering reporting officer (to act as the focal point for the oversight of the AML/CTF systems and compliance measures);
- a senior management staff of the applicant will be required to attend an interview with the C&ED;
- the licence of the Category B DPMS will only be valid for 3 years and must be renewed at least 60 days before expiry;
- any change to a Category B DPMS's partners, directors or ultimate owners requires the Commissioner's prior approval; and
- a Category B DPMS falls under the definition of DNFBP (Designated Non-Financial Businesses and Professions) under the Ordinance and is therefore subject to the relatively onerous customer due diligence requirements, record keeping requirements and miscellaneous requirements set out under Schedule 2 of the Ordinance.

Non-Hong Kong DPMS: Reporting

Non-Hong Kong DPMS refers to any person (including a legal person) who deals in precious metals and stones in Hong Kong:

- that does not ordinarily reside in Hong Kong, or is incorporated or established outside Hong Kong and is not a registered non-Hong Kong company as defined by section 2(1) of the Hong Kong Companies Ordinance (Cap.622);
- who or which does not have a place of business in Hong Kong; and
- the total number of days on which the person's precious metals and stones business is carried on in Hong Kong does not exceed 60 days in a calendar year;

Non-Hong Kong DPMS do not need to register with the C&ED. However, if they carry out any Specified Cash Transactions in Hong Kong, they must file a cash transaction report with the Commissioner.

Next steps and transition period

A transition period applies to local DPMS that hold a valid business registration certificate and have been carrying on a precious metals and stones business before 1st April 2023. This group of existing local DPMS will be deemed to be Category B registrants until the end of 2023. Local DPMS operating before 1 April 2023 should apply to be registered during this transition period.

Local DPMS who are looking to commence business after 1st April 2023 must apply for registration before commencing business.

Non-compliance with the registration obligation or ongoing obligations can constitute a criminal offence.

Contact



Katherine Liu

Partner

+852 2533 2717

katherine.liu@shlegal.com



James Wong

Associate

T: +852 3166 6933

E: james.wong@shlegal.com



Alan Wong

Associate

T: +852 2533 2719

E: alan.wong@shlegal.com



Conrad Chong

Trainee Solicitor

T: +852 2533 2857

E: conrad.chong@shlegal.com

Economic Crime Levy

From 1 April 2022, art market participants with a revenue of over £10.2 million are subject to the Economic Crime Levy (the "**ECL**"). The ECL will be charged on entities that are supervised under the Money Laundering Regulations at any time during the financial year from 1 April 2022 to 31 March 2023 (the "**ECL Reporting Year**"). The payment for this period will be due on 30 September 2023.

The proceeds of the ECL will provide resourcing for tackling money laundering and supporting the government's Economic Crime Plan.⁸

In a statement to Parliament on 27 March 2023, John Glen, Chief Secretary to the Treasury, set out in detail the Government's plans for the proceeds of the ECL⁹.



Finance Act 2022

The ECL was introduced by the Finance Act 2022 (the "**Act**") (as supplemented by the Economic Crime (Anti-Money Laundering) Levy Regulation 2022 (SI 2022/269)). This provides that any person carrying on regulated business must pay the ECL if that person's UK revenue for the financial year is "medium", "large", or "very large".

The Act then sets out three 'thresholds' of revenue and a corresponding, fixed ECL fee as follows:

- "Medium revenue" – UK revenue for the 'relevant accounting period'¹⁰ of more than £10.2 million but less than £36 million: ECL payable is £10,000.
- "Large revenue" – UK revenue for the 'relevant accounting period' of more than £36 million but less than £1 billion: ECL payable is £36,000.
- "Very large revenue" – UK revenue for the 'relevant accounting period' of more than £1 billion: ECL payable is £250,000.

If an art market participant has a UK revenue of less than £10.2 million, the ECL will not be payable. In addition, if an art market participant only carries on a regulated business for part of the financial year, the ECL payable will be proportionately reduced. This reduction will be calculated using a daily apportionment of the time the art market participant is supervised under the Money Laundering Regulations. If an art market participant's accounting

period is shorter than 12 months, the ECL band sizes are adjusted accordingly.

UK revenue

The Act therefore centres around the concept of annual 'UK revenue'. This has two elements.

The first is the "UK" element. For a UK resident person, 'UK revenue' means all revenue attributable to the activities of overseas permanent establishments (on a just and reasonable apportionment) shall be deducted. For a non-UK resident person, UK revenue is revenue attributable, on a just and reasonable apportionment, to the activities of permanent establishment(s) in the UK.

The second element is 'revenue', which is defined as:

- turnover, which is in turn defined as amounts derived from the provision of goods and services after deduction of trade discounts, VAT and any other taxes (other than the ECL itself) based on the amounts so derived; plus
- any other amounts which, in accordance with generally accepted accounting practices ("GAAP"), are recognised as revenue in the profit and loss account or income statement for the accounting period (or which would be so recognised if the accounts were drawn up in accordance with GAAP); minus

⁸ [Economic crime plan 2023 to 2026 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/economic-crime-plan-2023-to-2026)

⁹ [Written statements - Written questions, answers and statements - UK Parliament](https://www.parliament.uk/business/committees/committees-a-z/commons-clerks/written-questions/answers-and-statements/)

¹⁰ The 'Relevant account period' is the accounting period which ends in the ECL Reporting Year

- distributions from connected companies, provided the distribution is not made in respect of shares or assets, the profits from the sale of which would be a trading receipt.

Practical implications

ECL is collected by the relevant person's anti-money laundering supervisor, which in the case of art market participants is HMRC.

Art market participants must register online for the ECL with HMRC. Once registered, there is no need to re-register for subsequent years. Current HMRC Guidance can be found online, (following the link in the footnote)¹¹.

Art market participants must submit a return and pay the ECL liability online by 30 September each year. HMRC will publish further guidance later in 2023 about how to make an ECL payment.

Contact



Alan Ward

Partner

T: +44 20 7809 2295

E: alan.ward@shlegal.com



Anna Purvis

Trainee solicitor

T: +44 20 7809 2107

E: anna.purvis@shlegal.com

¹¹ [Get ready for the Economic Crime Levy - GOV.UK \(www.gov.uk\)](https://www.gov.uk/get-ready-for-the-economic-crime-levy)

AI, IP & Art: where do we stand

What is art? What is artistic expression? Can machines express art as humans can and how should society value and protect machine generated art? These questions are not new. However, the explosion of generative AI systems into the public consciousness over the last year has pushed these questions to the fore. In this article, partner Peter Dalton and managing associate Joshua Cunnington consider how the technology interfaces with intellectual property laws, in particular whether artists can protect their AI works through copyright and whether the systems carry inherent infringement risks for their creators and users.

The state of the (AI) art

The concept of using statistics and rules to generate images is not new; as early as the 1970s the AARON system utilised a rule-based approach to generate images which were, while basic, described as art. In recent years there has been an explosion of innovation in AI, and a combination of significant advancements in hardware processing power, the AI techniques used, and the availability of extremely large datasets has led to AI image creation becoming vastly more powerful and innovative, and widely available to the public at large. Generative AI systems such as Midjourney, Stable Diffusion or DALL-E are capable of producing detailed images based on simple text prompts and can be accessed with ease from almost any internet connected device using web-based interfaces. Whilst the output of these tools can be erratic, recent examples have highlighted the creative possibilities of harnessing AI. In 2016, a collaboration between ad agency J. Walter Thompson Amsterdam, ING Bank and Microsoft used AI to analyse all 346 of Rembrandt van Rijn's paintings and 3D print *The Next Rembrandt*, a physical painting which imitates the Dutch Master's style down to the brushstrokes and layers of paint. More recently, a photograph titled *The Electrician* won an award at the Sony World Photography Awards before the apparent creator of the image, Boris Eldagsen, rejected the award and revealed that the image was created using AI.



The Next Rembrandt – J Walter Thompson Amsterdam, ING Bank, Microsoft and others



The Electrician - Boris Eldagsen

The issues with AI image generation

The generation of images with no or very little human input (other than the training of the systems to begin with) raises big questions which have been in discussion, largely on the periphery of the art world, for decades. If there is no human expressing the work, is there an artist? Is it the human prompter, or can the machine be an artist even though it is incapable of understanding its outputs in the human sense of the word? Is this even art? Esoteric these questions may be, they go to the core of the first question we discuss in this article, namely whether images generated by AI systems are protected under the existing copyright regimes. We then go on to discuss whether the training of AI systems and the creation of images by these systems might constitute copyright infringement. Given the rapid development of publicly accessible AI systems in recent years, the answers to these questions are not clear cut and there are differing approaches between jurisdictions, in particular between the UK, EU and US.

How do generative AI systems work?

Before exploring the legal questions around copyright ownership and infringement in AI image generation, it is helpful to explore how AI systems generate images. AI images and art works are typically created using generative AI systems trained on huge pre-existing data sets, which were created by 'scraping' huge volumes of data from publicly available sources on the internet. Once trained, generative AI systems use generative algorithms and deep learning techniques to produce new images autonomously, based on machine learning points and statistical weights developed during the training process. These systems are not, therefore, intelligent in the human sense and are incapable of experiencing or expressing human feelings or emotions; they have been described as "stochastic parrots" by one former Google researcher.

As we have explained, AI art is not new and has been in development since at least the 1970s. More recently, we have seen the design and creation of generative adversarial networks (or GANS), which use a generator to create new images and a discriminator to help decide which images are 'successful' or not. Current models, such as those used for Stable Diffusion and DALL-E, are 'diffusion' based. This involves training the AI system on huge databases of existing works, with the system then adding 'noise' to the images, which the system then learns how to remove, or 'de-noise', to recreate to the original image. Once the AI system has been trained over millions of iterations, it is then able to create new images by applying the 'de-noising' technique in accordance with text prompts.

As noted above, generative AI systems need to be trained on vast data sets, with most of the best-known AI image systems using data from the Large-scale Artificial Intelligence Open Network ("LAION"). LAION is a non-profit organisation that provides multiple data sets for use with AI, notably including the LAION-5B image data set which includes data from over 5.85 billion images scraped from the internet.

Copyright protection for AI artworks

Without copyright protection, artworks do not benefit from any protection against being copied. The consequence of this is that it becomes almost impossible for artists, especially those who produce prints of their works, to control supply and therefore the value of their works. Of course, original paintings

and signed limited edition prints will hold value in and of themselves, but the question becomes more difficult when we enter the realm of digital works. If the art work is a digital image generated by an AI system, it is difficult to see how the art work can attract value without copyright protection.

Divergent approaches to whether AI generated images can benefit from copyright protection have recently emerged from the UK, EU and US.

The UK is something of an outlier in this regard, as the Copyright, Designs and Patents Act 1988 (CDPA) specifically provides for the protection of computer-generated artistic works (defined as artistic works generated "*in circumstances such that there is no human author*"¹²). The author of the work is deemed to be "*the person by whom the arrangements necessary for the creation of the work are undertaken*"¹³. Computer-generated artistic works are given a 50 year term of copyright under the CDPA, distinguishing them from works created by a human author for which copyright subsists for the life of the author plus 70 years. The reason this specific computer-generated copyright exists can be traced back to the UK government's extensive AI development programmes of the 1970s and 1980s. At the time, there was significant interest and belief in AI and records of parliamentary debates over the CDPA in the 1980s highlight the belief at the time that AI works needed protection to allow the AI industry to flourish. Whilst there may have been a comparatively fallow period between the introduction of the law and now, the statute has suddenly gained much greater importance with the rise of generative AI systems. That said, it remains to be seen how the UK courts will approach the issue of copyright in AI generated images because of the different way in which EU copyright law – which has influenced UK case law over the last few decades, especially as regards to the test for originality – approaches the issue.

Under EU law, a key factor for whether copyright subsists is whether the work represents the author's "own intellectual creation", which is the test applied under EU law to determine whether a work is original, and which to some extent has been applied by the UK courts alongside (with a degree of tension) the more liberal test simply requiring some element of labour, skill or effort. The "intellectual creation" test derives from a case¹⁴ involving photographs, which held that portrait photographs would only attract copyright protection if creative

¹² Section 178 Copyright, Designs and Patents Act 1988

¹³ Section 9(3) Copyright, Designs and Patents Act 1988

¹⁴ *Eva-Maria Painer v Standard VerlagsGmbH and others* (C-145/10)

choices, such as those in the setup, shooting and development of the photo could be demonstrated. Likewise, a recent EU Commission paper on AI generated works notes that AI images may be protected by copyright if they are the result of human creative choices "*expressed*" in the output. Such expression, however, can include the selection and arrangement of generated works, meaning that the potential for protection under the EU framework remains; how this will be applied in practice remains to be seen.

Meanwhile, the US takes the strictest approach, with copyright only subsisting in works created with an element of "*human authorship*". The US Copyright Office recently clarified the meaning of "*human authorship*" in the context of AI image generation noting that, generally speaking, only the "*human authored characteristics*" are capable of copyright protection and that copyright could not protect elements where there is insufficient human creative control. It is therefore unlikely that US law will allow protection of AI art works and that only elements added in the traditional sense by humans will be capable of protection.

The upshot of these diverging approaches means that whilst it is likely that AI works will be protected in the UK and, to some extent the EU, a much more stringent test will be applied in the US meaning that no – or extremely limited – protection will be granted.

Does the training of AI systems or generation of images infringe copyright?

Under UK law, AI art presents two main potential infringement risks: (i) the gathering and using of training data; and (ii) when generating images.

Firstly, the 'scraping' and use for commercial purposes of data from the internet can constitute copyright infringement under the CDPA. Whilst the EU has introduced a general 'text and data mining' exemption to copyright infringement, the UK has recently decided against such an approach. The copyright infringement risks posed to generative AI art platforms are therefore significant in the UK.

Secondly, the generation of images and their subsequent use could also constitute infringement, thereby creating liability for the artist using the system to generate an image. The risk here is that the platform will create an image which is substantially similar to a pre-existing copyright work.

Notably, the main platforms exclude liability for copyright infringement in outputted works and instead place that liability on the user.

These risks are not just theoretical: both are the subject of a recent UK and US claims brought by Getty Images against Stability AI, the company behind the Stable Diffusion platform. Getty claims that both the training and generation of images using the platform infringes its copyright, pointing to Getty Images watermarks reproduced in Stable Diffusion images. It is not an exaggeration to suggest that the cases pose an existential risk to the whole generative AI art ecosystem. Putting the damages to one side (Getty seeks a huge US\$1.8 trillion), in the absence of an exception to copyright infringement or a licence, the training and potentially the use of these platforms is simply unlawful. Cases in the US are likely to centre on whether the "fair use" copyright defence under US law applies to the training of AI systems (a defence not available in the UK to the same extent), however recent caselaw from the US Supreme Court has made many commentators less positive about the prospects of fair use saving AI systems from copyright infringement claims.¹⁵

Looking forward

Despite the risks noted above, generative AI is set to have a huge impact on the commercial art world. Over time this impact is likely expand beyond digital media to all artistic mediums if AI systems are applied in a similar manner as in the Next Rembrandt project. That project shows that it is already possible for an entirely new physical work to be produced by a machine based on the style of a long-dead artist.

Unless governments enact copyright exceptions for AI training purposes, it is likely that AI operators will have to obtain licences to data to have sufficient data sets for training. This could be a positive for the art world and could create new revenue streams for artists and galleries, who could look to obtain fees to license images to the AI systems. Moreover, it is possible that we will see artists licensing their 'style' for the production of AI works, in a similar fashion to the way in which some artists rely heavily on assistants and workshops now. Because of this we may also see developments in copyright and under the law of passing off to help protect artists' styles (rather than individual works), the nature and scope of which can be very difficult to define.

¹⁵ Andy Warhol Foundation for the Visual Arts, Inc., Petitioner v. Lynn Goldsmith, et al., 598 U.S. (2023)

From a technical perspective, there has already been a rise of 'opt-out' mechanisms that theoretically allow companies and individuals to opt-out from allowing their data to be scraped for AI training, and these mechanisms are likely to become more prevalent with the increase in use of AI. However, AI operators have warned of the technical difficulties of implementing such schemes. Similarly, it is likely that web-based anti-copyright infringement tools will be introduced, which could be licensed to websites for a small fee to protect against unauthorised data scraping.

It is also possible that new legislation will be introduced to enable generative AI systems to operate within a more regulated environment, offering protection to consumers whilst also enabling AI systems to lawfully access more data than they might otherwise be able to. Licensing structures, such as collecting agencies seen in the music industry, could be a solution, although to date government interest in these has been limited.

What is certain is that the rise of generative AI systems brings both opportunities and uncertainties for the art and legal worlds. Striking the balance between effective copyright enforcement, to protect artists' rights, and allowing AI systems sufficient access to data, to be able to function as a useful tool, will be key to the effective, positive and lawful development of AI systems for use in the art world.

Contact



Peter Dalton

Partner

T: +44 20 7809 2151

E: peter.dalton@shlegal.com



Joshua Cunningham

Managing associate

T: +44 20 7809 2256

E: joshua.cunnington@shlegal.com



Matthew Angell

Trainee solicitor

T: +44 20 7809 2669

E: matthew.angell@shlegal.com