

Unroll the Scroll Painting: Inside the Chinese Art Market and Its Regulatory Landscape

Article By:

Art Law Practice

When Christie's Auction House first entered the secondary art market of mainland China in 2005, it licensed its brand to a local auction house and received a total of RMB 97,000,000 (roughly \$12,100,000) for its inaugural sale.^[1] With eight years of experience in this nascent market, Christie's started its independent business by establishing a branch in Shanghai and obtaining an auction license shortly afterward. Early March this year, Christie's realized a total of RMB 222,030,200 (roughly \$35,000,000) in its inaugural sale, selling 95% by lot and 90% by value, at its new gallery, BUND ONE, a century-old historical building in the heart of Shanghai.^[2]

Similarly, a rapid growth trajectory over the last two decades can also be found in China's primary art market. An increasing number of well-respected international galleries have opened their Chinese branches to capture this market potential. Concentrated in two major art hubs—Beijing (Galleria Continua in 2004 and Pace Gallery in 2008) and Shanghai (Perrotin in 2018, Almine Rech Gallery in 2019, and Lisson Gallery in 2019), these international galleries collectively formed a competitive force against the domestic galleries. At the same time, art fairs such as West Bund Art & Design^[3] and ART021 Shanghai Contemporary Art Fair^[4] have brought together top galleries, artists, and art lovers from around the world, contributing to large volumes of international art transactions and accelerating the integration of China's art market with the global art market.

A Relaxed Regulatory Environment

A relaxed regulatory environment helps explain the enormous growth of the Chinese art market. Unlike the highly restricted media industry, the art industry in mainland China is much more welcoming to foreign investors. The current edition of the Negative List for Foreign Investment allows foreign direct investment in all sectors of the art industry except antiques-related businesses (i.e., auction stores, antique auction houses, and state-owned antique museums).^[5] A business filing and an auction license are required to establish an auction house in mainland China. For a wholly foreign owned enterprise, the threshold of an auction license has been lowered since 2019, when the PRC Ministry of Commerce amended the Auction Administration Regulation.^[6] It requires an entity applying for an auction license to have at least RMB 1 million (roughly \$160,000) registered capital, at least one auctioneer, physical premises, by-laws, and an auction procedure. Establishing a gallery in mainland China is easier as mere business filing is sufficient, and no license is required.

In addition, as a night watchman, the government keeps the intervention to the business activities in the non-antique art industry at a very low level. The regulation of the auction business relies on legislation and, more frequently, the industry self-regulation. The Auction Law of PRC^[7] and relevant regulations share quite a number of provisions with the PRC Civil Code, the Anti-unfair Competition Law and the Product Liability Law and also contain auction-specific provisions such as conflict of interest rules and auction procedures. For the industry self-regulation side, China Association of Auctioneers^[8], as the auction industry association, has set forth a series of detailed industry standards and contract forms for various types of auctions. The standard for art auctions, for example, covers a wide range of topics, ranging from lots collection to catalogue compilation, from industry terminology to best practices for auctioneers.

The regulation of galleries is even less strict. The regulation that is specific to the art industry, the Art Deal Regulation, contains three prongs: business filing, redlines for business activities, and import and export compliance.^[9] Admittedly, most of them are intuitive or procedure-oriented. For example, art dealers are prohibited from concealing the origin of the art from buyers or forging the authentication documents.

Survival in a Unique Landscape

The contrast of regulatory complexity in the primary and secondary art market reflects a unique landscape in the Chinese art market: the dominance of the secondary market over the primary art market. In Western countries, the primary market (mainly consisting of galleries) and the secondary market (mostly auction houses) each play a distinctive role. But, in mainland China, a lot of resources and market professionals are concentrating on the auction business.^[10] The auction houses in China have been tapping into the primary art market for a decade. On the one hand, they collect lots directly from artists rather than solely from collectors. On the other hand, some of the leading auction houses, such as Beijing Poly and China Guardian (two of the world's top five auction houses), have been expanding their private sales business since 2013 when the Auction Supervision Regulation^[11] removed the ban on auction houses from private sales.^[12] Such expansion might explain why China was able to lead the global public auction market in 2021 by its 33% market share.^[13]

Surprisingly, quite a few international galleries opening their Chinese branches survived and thrived in this unique landscape and even helped balance the two markets. Two factors are essential to their success: timing and authenticity. Most international galleries entered the Chinese art market throughout the last decade, which turned out a perfect timing because the Chinese art market has evolved into a new stage in this decade. 2011 not only witnessed China's art market becoming the largest in the world, but also heralded the bubble burst. The volume of transactions at art auctions in 2012 dropped over 53% as a significant number of short-term investors realized that the art market was not an avenue for them to achieve quick returns on capital, and they subsequently exited the market.^[14] Since that decline, the Chinese art market has transitioned from an earlier stage in which auctions had been the key driver of the growth to the current stage in which the importance of the primary market is being recognized.^[15] Collectors have become more rational and mature and tend to focus their investment on renowned Western artists (especially contemporary art) because of high market potential and low price volatility. In addition, with more access to Western art through exhibits and art fairs over the last decade, more people are able to appreciate and desire Western art while drastic economic and social transformation also enabled them to enjoy conspicuous consumption, spending their disposable income in areas such as art collecting. When the rising demand for western art met the arrival of western galleries, these galleries, by virtue of their artist resources, gained an inherent competitive advantage over the domestic galleries.

The galleries also enjoy an edge in the competition against auction houses that are immune from certain claims by buyers. The Auction Law has a safe harbor provision, protecting auction houses against any forgery claim or product claim as long as they make a prior good faith disclaimer that they will not guarantee the authenticity or the quality of the lot. In practice, most auction houses have included such a disclaimer in their conditions of sale. Such practices have triggered multiple lawsuits arising out of claims of art forgery. But most of these disputes ended with courts affirming the enforceability of such disclaimer^[16], pushing art collectors who have concern over the authentication to the primary market. Because galleries can acquire artwork directly from their represented artists, the risk of purchasing a forgery can be reduced to a minimal level.

Challenges: exchange control and tax.

For international galleries, challenges remain in conducting cross-border art transactions, particularly with respect to exchange control and the tax burden inflicted by the Chinese government.

To stabilize the RMB exchange rate, the Chinese government has been strengthening its foreign exchange control. Every Chinese citizen can convert RMB into foreign currencies up to a maximum of \$50,000 per calendar year.^[17] This creates a problem for international galleries that do not have a physical presence in China because the quota is so low that it can be easily exceeded by the purchase of a single piece of artwork. Some Western galleries have come up with innovative ways to seek to reduce these complexities and enable domestic Chinese collectors to buy art by working with financial or legal service providers to design a special payment structure to help collectors clear these hurdles.^[18]

However, taxes presents an even bigger challenge. Every cross-border art transaction is subject to VAT (value-added taxes) and tariffs. For each purchase, the total tax rate is calculated as $(1 + \text{VAT rate}) \times (1 + \text{tariff rate}) - 1$.^[19] The VAT for imported goods has been reduced to 13% from 16% since 2019.^[20] The tariff rate varies depending on the media of art, ranging from 6% for photography to 1% for painting and sculptures and 0 for installation art.^[21] For example, if mainland Chinese collectors acquire Western paintings and want to bring them to their domestic residences, the total tax rate would be $(1 + 13\%) \times (1 + 1\%) - 1 = 14.13\%$.^[22] The tariff rate sometime would also be affected by geopolitics. During the Sino-U.S. trade war in 2018, Chinese customers imposed a retaliatory tariff on artworks from America or made by American artists. The heavy tax burden has pushed many Chinese collectors to choose free-port cities such as Hong Kong as the place for delivery.^[23]

However, every cloud has a silver lining. In recent years, Shanghai and Beijing's local governments have taken initiatives to build bonded warehouses such as Le Freeport Shanghai Westbund, Shanghai Waigaoqiao Free Trade Zone, and Beijing Tianzhu Free Trade Zone. Storing artwork at bonded warehouses can significantly lower the stress on cash flow and streamline customs clearance procedures for art dealers. Also, the central government offered various preferential policies for the art dealers in the China International Import Expo, which is the world's first import-themed expo and has been held in Shanghai annually since 2018 to promote the Chinese domestic market to foreign companies. For example, in the recent two Expos, the government exempted art dealers from VAT and tariff for any five artworks or cultural property it would sell during the Expo to encourage the repatriation of cultural property.^[24]

As we can see from the example of the Expo, the gate of the Chinese art market will continue to open, echoing Xi Jinping's 2014 ambition to make Shanghai the new APAC hub for international art trades.^[25]

FOOTNOTES

- [1] <https://www.christies.com/presscenter/pdf/10042006/102159.pdf>
- [2] <https://www.christies.com/about-us/press-archive/details?PressReleaseID=10331&lid=1>
<https://www.christies.com/about-us/press-archive/details?PressReleaseID=10390&lid=1>
- [3] <http://www.westbundshanghai.com>
- [4] <https://www.art021.org/en/>
- [5] ?????????????? (????)(2021 ??) ?
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- [6] http://www.gov.cn/gongbao/content/2020/content_5480486.htm
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- [10] <https://2019.amr.tefaf.com/chapters-print/?printMode=true>
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- [12] <https://news.artron.net/20130116/n301176.html>
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- [14] <https://2019.amr.tefaf.com/chapters-print/?printMode=true>
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- [16] <http://temp.pkulaw.cn:8117/qikan/1510242135.html>
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- [21] <http://www.chinartlaw.com/index.php?r=post%2Fview&f=111&id=886>
- [22] <http://www.chinartlaw.com/index.php?r=post%2Fview&f=111&id=886>

[23] <https://2019.amr.tefaf.com/chapters-print/?printMode=true>

[24] https://www.ccdi.gov.cn/yaowen/202111/t20211104_253741.html

[25] <https://www.pudong.gov.cn/019001002/20220304/668557.html>

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