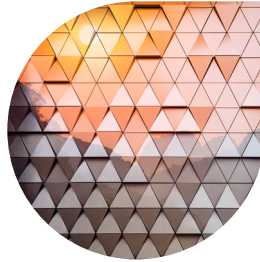


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## EU Carbon Border Adjustment Mechanism (CBAM): What you need to know

The EU's **Carbon Border Adjustment Mechanism (CBAM)** and **EU Emissions Trading System (ETS)** are both aimed at reducing carbon emissions by placing a price on carbon. They are intended to be complementary, with the revised ETS applying to intra-EU goods and the CBAM applying to goods imported into the EU. The CBAM would apply a cost of carbon to imports of certain goods based on the carbon emissions associated with their manufacture. It is intended to prevent so-called “carbon-leakage”, i.e. relocation of energy intensive production from the EU to countries with lower levels of regulation of GHG emissions.

### Key Takeaways

- > CBAM applies to cement, fertilizers, iron and steel, aluminum, electricity and hydrogen imported into the EU.
- > Importers will need to be authorised by national authorities from whom they can buy CBAM certificates. Importers will have to declare the quantity of in-scope goods and their total embedded carbon emissions and surrender corresponding numbers of CBAM certificates.
- > From 1 October 2023 until the end of 2025, importers of in-scope goods will only need to submit quarterly reports but no CBAM certificates must be surrendered yet. From 2026 onwards, the obligations will apply in full.
- > EU companies will need to prepare themselves for reporting obligations imposed under the CBAM, while non-EU companies will need to get ready to provide information on embedded carbon emissions in their products to EU importers.



### What is the CBAM?

The CBAM would initially apply to cement, fertilizers, iron and steel, aluminum (as well as certain precursors and downstream products such as screws and bolts), electricity and hydrogen imported into the EU. Electricity imported from countries that have an integrated market with the EU, where there is no technical solution for the application of the CBAM, is exempt, subject to certain conditions to be assessed by the Commission. Certain countries that already participate in the EU ETS (such as Norway) or apply the same carbon price (such as Switzerland) are also exempt.

For iron and steel, aluminum and hydrogen, only direct emissions (i.e. emissions from the production of these goods) are taken into account. For other goods (except for electricity), embedded emissions also include indirect emissions from the production of the electricity used during the production process.

Where the actual emissions cannot be determined as well as in case of indirect emissions, the embedded emissions are determined by reference to default values provided for in the CBAM Regulation. Importers of electricity will also need to use default values unless they can meet certain criteria for calculation based on actual emissions.

### Who does it apply to?

Importers of in-scope goods will need to be authorised by the competent national authorities from whom they can buy CBAM certificates. Applications will be submitted via the CBAM registry (electronic database) to be established by the Commission.

### How will it work in practice?

Once fully in place from the start of 2026, the CBAM will work as follows:

- > the price of the CBAM certificates will be calculated by reference to the weekly average auction price of EU ETS allowances;
- > the importer will need to ensure that the number of CBAM certificates held by it at the end of each quarter corresponds to at least 80% of the embedded emissions determined by reference to default values, in all in-scope goods it has imported into the EU since the beginning of the year;
- > from 1 October 2023, the importer will have to submit quarterly CBAM reports (with the first report due in January 2024) on the quantity of in-scope goods imported into the EU during the relevant period and their total embedded emissions. By the end of each compliance year (31 May) and for the first time in 2027 for the year 2026, the importer will have to submit CBAM declarations containing the same information. The information in the CBAM declaration will have to be verified by an accredited entity;
- > the importer will have to surrender a number of CBAM certificates corresponding to its total embedded emissions according to the CBAM declaration;
- > if a carbon price has already been paid in a third country, then a corresponding amount can be deducted from the compliance requirement, taking into account any rebates or other compensations available in that third country. This information will have to be certified by an independent person from both importer and relevant third country authorities; and
- > at the request of importers submitted before 30 June each year, national authorities will repurchase excess CBAM certificates remaining on an importer's account, not exceeding one third of the total number of CBAM certificates purchased by that importer during the previous year. The Commission will cancel any unused CBAM certificates purchased during the previous calendar year on 1 July of each year.

### When will it apply?

The CBAM Regulation was published in the Official Journal of the EU on 16 May 2023 and entered into force on 17 May 2023. It applies from 1 October 2023, with certain provisions such as those related to the CBAM registry and authorisations applying from 31 December 2024.

From 1 October 2023, importers will only need to submit quarterly CBAM reports, but no CBAM certificates must be surrendered yet. From 1 January 2026 onwards, the CBAM obligations will apply in full.

### Interaction with EU ETS

Free ETS allowances for CBAM sectors will be gradually phased out between 2026 and 2034. Until free allocations under the EU ETS end, the CBAM certificates to be surrendered will be adjusted to reflect such free allowances. The Commission can adopt delegated acts laying down detailed rules for the calculation of the adjustment.

### Penalties for non-compliance

The CBAM Regulation provides penalties for non-compliance. In particular, for a failure to surrender the necessary number of CBAM certificates the importer will be subject to a penalty equal to the excess emissions penalty under the EU ETS, which is €100 per tonne of carbon dioxide equivalent, multiplied by the European index of consumer prices. Importing goods without obtaining the status of an authorised CBAM declarant will also be subject to a penalty to be established by the individual Member States. That penalty will have to be “effective, proportionate and dissuasive” and three to five times the penalty for non-surrendering the required number of CBAM certificates.

The Commission has the power to amend the list of in-scope goods if it has sufficient reasons to believe that circumvention practices are occurring (such as changes in the pattern of trade in goods, processes or work – e.g. slightly modifying the goods with insufficient due cause or economic justification other than CBAM avoidance).



### What's next?

The CBAM Regulation requires or empowers the Commission to adopt a number of delegated acts in order to clarify various procedures provided under the CBAM. Certain powers (e.g. on accredited verifiers, sale and repurchase of CBAM certificates and circumvention) are granted for five years with possible subsequent extensions.

Before the end of 2025, the Commission will need to evaluate how the CBAM is working and whether to extend its scope to more products and services – including whether to cover indirect emissions from iron and steel, aluminum and hydrogen, as well as other goods at risk of carbon leakage (such as organic chemicals and polymers) and other input materials (precursors). Before the end 2024, the Commission will also need to present a report to the European Parliament and the Council that identifies products further down the value chain of in-scope goods that it recommends for inclusion in the CBAM.



### Getting ready

EU companies will need to prepare themselves for reporting obligations imposed under the CBAM, including through an assessment of their supply chains of in-scope goods and establishing the processes to collect the necessary data, as well as creating internal reporting procedures. They may also face price increases of in-scope goods as well as secondary goods (that include components of in-scope goods), which they may or may not (or partly) pass on the cost to their customers.

Non-EU companies will need to get ready to provide information to EU importers on embedded carbon emissions and the carbon price payable in their countries, as well as any applicable rebates or compensations.



### WTO complaints

According to press reports, a number of countries have expressed concerns about the EU CBAM, with China and India planning to challenge it before the WTO. In particular, the EU may be required to submit a report to WTO members so that they can discuss the consistency of the CBAM with WTO rules. However, the EU has stated that it has already presented the CBAM to WTO members during the legislative process. The European Commission highlighted that the CBAM has been designed in such a way that it is compatible with WTO rules.

Although the EU are the first to launch a CBAM, it is possible that others may follow their example. For example, the UK government is currently **consulting** on options for dealing with carbon leakage, including proposals for a UK CBAM.

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