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Tax & Legal

EU ETS & CBAM: key pieces of legislation formally adopted

The end of a lengthy decision-making process results in a conclusive green light



The European Parliament and Council of the European Union formally adopted the Carbon Border Adjustment Mechanism (CBAM), the European Union Emissions Trading System (EU ETS) and Social Climate Fund (SCF) on 18 and 25 April 2023 respectively. This marks a significant milestone in the EU's commitment to tackling climate change, delivering on its 2030 climate targets, and achieving its goal of becoming climate neutral by 2050.



EU ETS and CBAM: An overview

The EU ETS, which currently applies to limited energy-intensive, high emitting industries, is an European market for emission rights based on a cap-and-trade system that sets an annual cap on the amount of greenhouse gases that companies in covered sectors may emit. This amount is covered by allowances, which are tradeable. Within the cap, companies either

receive emission allowances for free or buy them, and unused allowances can be sold or used the following year. The cap is gradually reduced over time to ensure emissions reductions, which also means that the market price for allowances may continue to rise, creating an incentive for companies to reduce their emissions.

The revision of the EU ETS entails extending the covered sectors to include maritime transport, phasing out free allowances, reducing the number of allowances in circulation, and creating a new, separate ETS ("ETS II") for the transport and real estate sectors with regard to the emissions released during road transport and the heating of buildings.

The CBAM, which mirrors and is a supplementary measure to the EU ETS, operates by imposing a charge on the embedded carbon content of certain imported products. This is equal to the charge imposed on the production of domestic goods under the ETS (net of free permits), with adjustments being made to this charge to take into account any mandatory carbon prices in the exporting country.

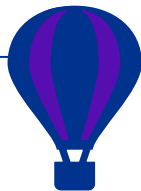
CBAM aims to incentivise non-EU countries to increase their climate ambition and to ensure that EU climate efforts are not undermined by production being relocated from the EU to countries with less ambitious climate policies.

Timing

The reduction in the overall EU-wide quantity of EU ETS allowances in circulation will take place over two years, commencing in 2024, and the phase-out of free allowances will commence in 2026. Free allowance allocations for the aviation sector will be phased out by 2026, and the maritime sector will be included in the EU ETS through a phased-in approach commencing in 2024.

ETS II for the buildings and road transport sectors and fuels for certain industrial sectors (such as manufacturing) will be established by 2027. However, the implementation may be postponed to 2028 to protect citizens if energy prices are exceptionally high.

The CBAM will be phased in at the same rate that the free allowances in the ETS will be phased out, covering specified goods within the iron and steel, cement, aluminium, fertiliser, electricity and hydrogen sectors. During a three-year transitional phase commencing 1 October 2023, affected importers will only be required to fulfill reporting obligations, with the first quarterly report due by 31 January 2024. Thereafter, from 1 January 2026, CBAM will be fully operational and financial obligations will take effect, whereby CBAM certificates will have to be surrendered.



What next?

The new laws will be signed by the European Parliament and the Council of the European Union and published in the EU's Official Journal before entering into force 20 days later.

The immediate first step for companies based within the EU or trading with the EU to take is to assess the impact that these imminent changes will have on their operations.

KPMG has the specialized knowledge and global coverage necessary to help clients make informed decisions, minimize risks and take full advantage of opportunities arising from the EU's decarbonisation efforts.

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