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Carbon Border Adjustment Mechanism (CBAM) – What is it About?

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What is CBAM?

Simply put, CBAM is an EU proposal to ensure that imports of certain goods to the EU pay the same price on carbon emissions, as would have been paid if these goods have been produced in the EU. The EU Commission presented a proposal for a new CBAM Regulation in July 2021 ([carbon_border_adjustment_mechanism_0.pdf \(europa.eu\)](#)), as part of the Fit for 55 Package. This is a set of measures aiming to help the EU to reduce greenhouse gas emissions by 55% in 2030.

To understand why there is a need to put a CBAM in place, we first need to look a bit at the context.

What is carbon pricing and why is it a good idea?

CBAM means putting a price on carbon emissions. Why is that a good idea?

The global climate challenge requires urgent action. Climate science is clear, we are heading in the wrong direction. Recently, yet another alarming report showed that the increased global warming is driving us close to ‘tipping points’. Coral reefs will die, glaciers will melt, there is no turning back once we have passed those tipping points.

So, the time for action is now. The Paris Agreement has set goals but there are still huge gaps between aspirations and reality.

The benefits of putting an explicit price on carbon have since long been acknowledged in both research and in practice. Close to 80 jurisdictions across the globe have introduced explicit carbon pricing instruments, either carbon taxes or emission trading schemes ([State and Trends of Carbon Pricing 2022 \(worldbank.org\)](#)). There are numerous international bodies and organisations advocating such measures as cost efficient and effective measures to reduce emissions, such as the OECD, the World Bank and the Coalition of Finance Ministers for Climate Action. The UN has recently launched a Handbook of Carbon Taxation for developing Countries ([UN Handbook on Carbon Taxation for Developing Countries \(2021\) | Financing for Sustainable Development Office](#)) and is during its current mandate continuing analysing hands-on aspects on implementing such a measure.

Why is CBAM Needed?

The EU is raising its climate ambition. Changes of the current EU Emissions Trading Scheme Directive (EU ETS) is part of the Fit for 55 Package. However, as long as there are differences in climate ambition among EU's trading partners, there is a risk of carbon leakage when the EU raises its climate ambition. EU business risks to move out of the EU or imported goods with higher carbon footprints will replace EU produced goods. To ensure the effectiveness of the EU climate policy, proper measures to prevent carbon leakage are needed. That is why there is a need of CBAM.

How Come that CBAM is a Climate Measure?

As outlined above, the CBAM is not a measure to support EU industry. It has a strict climate objective in support of the fight against global climate change. This relates directly by ensuring effectiveness of EU climate policy on the EU market. It also gives incentives to 3rd country producers to reduce their emissions as well as incentivise 3rd countries to adopt green policy frameworks.

Imports will pay a carbon price under the CBAM. This corresponds to the price that would have been paid if the goods had been produced in the EU under the EU ETS. Mirroring the EU ETS is key. Ensuring that imported goods are not treated less favourably than EU produced goods ensures conformity with EU's international obligations, such as the rules of the World Trade Organisation (WTO). The legal act establishing CBAM is a Regulation laying down an obligation to surrender CBAM certificates covering the emissions embedded in the imported goods; it is not a tax nor a customs duty.

How Will it Work in Practice?

Once the CBAM is fully up and running, authorised declarants will by the 31th of May each year be required to declare the embedded emissions in the total goods they have imported during the previous calendar year. If these emissions have been subject to a carbon price in a third country, this is deducted from the financial CBAM obligation.

The declarants need to be pre-authorised and such an authorisation is a prerequisite for customs authorities to release the goods for free circulation into the EU. Importers or indirect customs representatives can apply for authorisation. The authorised declarants must also at the same time as filing their declarations, submit CBAM certificates covering the declared embedded emissions. These certificates are sold at the same price as EU ETS allowances but are not tradable.

In the first phase, CBAM is proposed to apply to goods within five sectors: cement, iron & steel, aluminium, fertilisers and electricity. In a second stage, the CBAM is planned to be extended to other EU ETS sectors. The embedded emissions need to be verified by verifiers accredited by a national accreditation body in an EU Member State. A detailed methodology for the calculation of the embedded emissions will be laid down by an implementing act. The EU Commission has recently launched an informal expert group with members and observers from Member States' authorities as well as business associations to provide advise and expertise in the work on establishing this methodology (<https://taxation-customs.ec.europa.eu/news/cbam-commission-launches-call-applications-informal>

-expert-group-2022-07-28_en).

However, the CBAM is proposed as a gradual phase-in to allow businesses to adjust. It will start by a three-year transitional phase with no financial obligation nor authorisation of declarants but a requirement for importers to report embedded emissions according to the set methodology. At this stage no verification is needed of the embedded emissions.

State of Play CBAM Proposal

The CBAM is a regulation to be decided under the ordinary EU legislative procedure, which means co-decision between the Council and the European Parliament. The ECOFIN Council adopted a general agreement on the CBAM proposal in March 2022 and the European Parliament's vote in plenary took place in June 2022. These agreements were the basis of the two institutions' initial positions in the negotiations to reach compromises and form a final agreement. Both legislations share a concern for a rapid adoption of a CBAM Regulation as an essential part of the Fit for 55 Package, establishing necessary tools for the EU to reach set climate goals.

Negotiations between the co-legislations are currently intensively carried out in so called trialogs. Both legislations see the need to find solutions to open issues and the Parliament and the Council, currently under the leadership of the Czech Presidency, aim to come to an agreement before the end of 2022, with the new mechanism entering into force in 2023.

By introducing a CBAM, an increased EU climate ambition is enabled and jurisdictions outside the EU are also given incentives to introduce climate policies to reduce emissions. Starting with CBAM does not preclude joint global work on international coordination of carbon pricing. But climate action is urgent, we need to act at all levels now, use all the tools in the toolbox. Let's all join forces to make the green train gain speed!

[1] The views expressed in this post do not necessarily reflect those of the Swedish Ministry of Finance.

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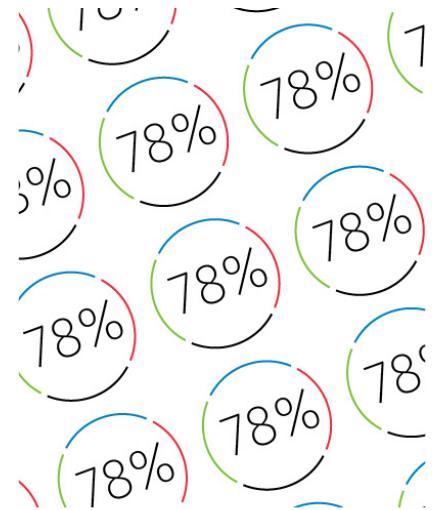
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