



## Deloitte Legal Newsflash

### Sustainability - Customs and trade

## EU Carbon Border Adjustment Mechanism (CBAM) – *Eureka?*

The long awaited proposal for a Regulation establishing a Carbon Border Adjustment Mechanism (hereafter ‘CBAM proposal’) was published by the European Commission.

The CBAM proposal is part of a broader legislative package, the so-called Fit for 55 Package, aimed at reducing greenhouse gas emissions (hereafter ‘GHG’) in the EU by 55% by 2030<sup>1</sup>.

The purpose of the CBAM proposal is to regulate GHG emissions embedded in specifically defined goods imported into the customs territory of the Union. Net imports of goods and services into the EU account for more than 20% of the EU’s CO<sub>2</sub> emissions<sup>2</sup>.

This would prevent the risk of carbon leakage, a term that describes shifts in economic activities and/or changes in investment configurations, directly or indirectly causing GHG emissions to be moved away from a jurisdiction with GHG constraints to another jurisdiction with fewer or no GHG constraints. To avoid such leakage, the CBAM proposal introduces a carbon price for imports of certain goods from outside the EU<sup>3</sup>.

Goods in scope are carbon intensive: cement, electricity, fertilisers, iron, steel and aluminium. It is not excluded that this list will be extended in the future. The CBAM proposal will apply to all third countries, except for members of the EFTA<sup>4</sup> and some territories related to EU countries<sup>5</sup>. Concerning electricity imports, other countries and territories can be excluded. Non-preferential rules of origin remain applicable for the determination of the goods’ origin.

National competent authorities will oversee the application and enforcement of this new mechanism. They will be responsible for all decisions that need to be taken, for granting authorisations, for selling CBAM certificates and enforcing CBAM rules. The Commission will act as a central administrator.

The proposal foresees a transitional period from 2023 to 2025 during which a reporting obligation will apply.

### **The Mechanism**

Importation, i.e. release for free circulation, of goods can only be made by an authorised declarant. A declarant is defined as the person lodging a customs declaration in his/her own name or a customs representative. This implies that all customs declarants and customs brokers/representatives dealing in concerned goods will need to be authorised. Authorisation implies that one will be held liable for failure to comply with CBAM obligations.

The authorised declarant must submit a CBAM declaration annually. This declaration will contain direct and indirect emissions embedded in imported goods during the previous calendar year, as well as the number of CBAM certificates corresponding to the aforementioned emissions.

Producers and/or exporters with installations in third countries will be able to request confirmation of the embedded emissions level in goods produced in those installations.

The CBAM is linked to the existing EU emissions trading system (ETS) and establishes a pool of allowances covering emissions embedded in imported goods and services from outside the geographical area covered by the ETS. The price of CBAM certificates will be averaged based on the closing prices of all EU ETS allowances conducted in auctions during each calendar week. For each declared emission, a reduction corresponding to the carbon price paid in the goods' country of origin can be claimed.

The customs authorities will be responsible for ensuring that the declarant of the goods is registered. They will also periodically inform the competent authorities of relevant imports based on import declarations' data.

### **Is the CBAM compliant with WTO obligations?**

The CBAM proposal is a balancing act between environmental considerations and the EU's obligations under the World Trade Organisation<sup>6</sup>. It must not be considered discriminatory or a disguised restriction on international trade<sup>7</sup>. It will be designed and used exclusively to advance climate objectives, not as a tool enhancing protectionism, i.e. restoring level playing fields for EU industries<sup>8</sup>.

Once adopted, the CBAM's implementation and execution will demonstrate whether it is WTO-compliant.

It remains to be seen whether industries will still be able to obtain free allowances under the EU ETS mechanism. The CBAM coupled with free allowances could be considered protectionism.

In the 2021 Work Programme, the CBAM is defined as an EU own resource. This could give the impression that the CBAM is a mere tax, rather than an instrument to advance climate objectives.

Finally the application of the CBAM may not lead to unwarrantable compliance burden and costs.

## What does it mean for you?

Exporters and/or importers will encounter an increase in administrative formalities to import goods in the EU. Market operators will need to implement new reporting requirements. Emission calculations will require information related to the country of origin, production methods and processes, input materials/resources, quantities and emission factors for consumption, production and exports of electricity, heating and cooling, factory inspections,...

For companies and consumers, the price of goods will likely increase due to the purchase of CBAM certificates and additional administrative formalities.

It is not excluded that third countries will (try to) react with retaliatory tariffs, trade remedies investigations, etc...

It should be noted that the text is still in a proposal phase. It will still need to go through the EU's ordinary legislative procedure where reviews and potential modifications could be made by the European Parliament and the Council of the European Union.

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<sup>1</sup> European Commission, *State of the Union: Commission raises climate ambition and proposes 55% cut in emissions by 2030* (compared to 1990 levels), Press Release, 17 September 2020.

<sup>2</sup> European Parliament, *Report towards a WTO-compatible EU carbon border adjustment mechanism*, 2020/2043(INI), 15 February 2021.

<sup>3</sup> European Parliament, EPRS, *Carbon emissions pricing: Some points of reference*, Briefing, March 2020.

<sup>4</sup> Iceland, Liechtenstein, Norway and Switzerland.

<sup>5</sup> Büsingen, Helgoland, Livigno, Campione d'Italia, Ceuta and Melilla.

<sup>6</sup> EP Legislative Observatory, Procedure file on *Towards a WTO-compatible EU carbon border adjustment mechanism*, 2020/2043(INI).

<sup>7</sup> GATT Art. I:1 (MFN treatment) and III (national treatment).

<sup>8</sup> GATT Art. XX (general exceptions).