

New EU Carbon Border Adjustment Mechanism

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On 1 October 2023, the EU's Carbon Border Adjustment Mechanism (CBAM)¹ entered into effect. The CBAM is set to eventually replace the EU's Emissions Trading System (EU ETS)² with the goal of addressing the EU ETS' inherent risk of "carbon leakage".³

I Background, Development, and Functioning of CBAM

The EU ETS was created in 2005 for trading greenhouse gas emission allowances in the EU, authorizing the European Commission to set an upper limit on the total amount of greenhouse gas emissions by companies in the EU. To this end, companies can purchase "emission allowances" from EU Member States or trade them with other companies.⁴

However, the EU ETS also permits EU Member States to grant subsidies to companies in the form of free allowances. These no- to low-cost allowances weaken the incentive for companies to invest in greenhouse gas emission reductions and distort competition between companies that receive free allowances and those that do not. The EU therefore thinks that the number of free allowances must be gradually reduced until they are completely phased out.⁵

However, without free allowances, companies could be incentivized to relocate their energy-intensive activities and plants to non-EU countries, thereby saving the cost of purchasing certificates. This is where the CBAM comes in: for certain imported goods from energy-intensive sectors, companies must determine their "grey emissions" and then "surrender" CBAM certificates corresponding to these emissions each year.⁶

"Grey emissions" are emissions that are released during the production of goods (direct emissions) as well as those released from the generation of electricity consumed during the production of goods (indirect emissions).⁷ While, in principle, both direct and indirect emissions are taken into account, there are exceptions for certain

1. Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism (<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0956>).

2. Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC (<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003L0087>).

3. CBAM Art. 1, paras. 2 and 3.

4. EU ETS Art. 12.

5. CBAM Recital 11 *et seq.*

6. See CBAM Art. 3, Nos. 24 and 25.

7. See CBAM Art. 3, Nos. 21 and 34; cf. "embedded emissions", CBAM Art. 3, No. 22.

goods made of iron, steel, aluminum, or hydrogen (listed in CBAM Annex II), allowing only direct emissions to be included in grey emissions calculations.⁸ The prices of CBAM certificates are based on the weekly EU ETS prices.⁹ As a result, non-EU goods are also subject to CO2 pricing by the EU.

II Scope of Application

The CBAM “reflect(s) the activities covered by the EU ETS”¹⁰ and applies to the import of goods such as cement, electricity, fertilizers, iron and steel, aluminum, hydrogen, and their processed products into the EU customs territory.¹¹ This requires a clear identification of imported goods based on the classification provided in CBAM Annex I. Goods with eight-digit combined nomenclature (CN) codes that are not listed in CBAM Annex I are not (yet) covered by the CBAM. The export of goods is not regulated by the CBAM.

III CBAM “Declarant”

Pursuant to CBAM Art. 4, goods may only be imported into the EU customs territory by an authorized “CBAM declarant”. Authorization applications can be made by any importers established in a Member State or by indirect customs representatives.¹² In addition to personal data, the economic operator registration and identification (EORI) number, the main business activity carried out in the EU, as well as the estimated monetary value and the estimated volume of goods imported into the EU customs territory must be provided.¹³ Authorization applications are submitted via the CBAM registry set up in accordance with CBAM Art. 14 and can be withdrawn at any time.¹⁴

IV Reporting Obligations During Transitional Phase Ending 31 December 2025

CBAM Art. 32 establishes certain interim reporting obligations pursuant to CBAM Art. 34 *et seq.* In conjunction with the implementing regulation for the reporting obligations (CBAM IR),¹⁵ these interim reporting obligations include essential data on corresponding imported goods. In addition, customs authorities have a duty to provide information in accordance with CBAM Art. 33, which, in addition to requiring that information be collected, primarily serves to raise awareness among importers that they must apply for authorization as CBAM declarants for imports. This interim phase will last until 31 December 2025 and aims to facilitate the transition from the current practice of free allocation of certificates to the CBAM.¹⁶

⁸ CBAM Art. 7, para. 1, sentence 2.

⁹ CBAM Art. 21.

¹⁰ CBAM Recital 28.

¹¹ CBAM Art. 2, para. 1, in conjunction with CBAM Annex I.

¹² CBAM Art. 5, paras. 1 and 2.

¹³ CBAM Art. 5, para. 5.

¹⁴ CBAM Art. 5, paras. 3 and 6.

¹⁵ Commission Implementing Regulation (EU) 2023/1773 of 17 August 2023 laying down the rules for application of Regulation (EU) 2023/956 of the European Parliament and of the Council as regards reporting obligations for purposes of the carbon border adjustment mechanism during the transitional period (<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R1773>).

¹⁶ CBAM Recital 12.

1. Mandatory Reporting

Pursuant to CBAM Art. 35, para. 1, importers, for each quarter of a calendar year in which they have imported goods, must submit a report (CBAM report) to the EU Commission no later than one month after the end of the quarter, with information on the goods imported in that quarter. Furthermore, pursuant to CBAM IR Art. 8, para. 1, a declarant subject to this reporting obligation must submit a CBAM report to the CBAM Transitional Registry and indicate whether the CBAM report is being submitted by an importer in his/her own name and on his/her own account (CBAM IR Art. 8, para. 2, lit. (a)) or by an indirect customs representative on behalf of an importer (CBAM IR Art. 8, para. 2, lit. (b)).

2. Penalties for Non-compliance

If a notifier subject to a reporting obligation fails to fulfil that obligation, the respective EU Member State can impose penalties of between EUR 10 and EUR 50 per ton of unreported emissions.¹⁷

V Implementation Phase Starting 1 January 2026

The CBAM implementation phase will start on 1 January 2026.¹⁸ From this date on, goods may only be imported into the EU customs territory by an authorized CBAM declarant pursuant to CBAM Art. 4.¹⁹ Each authorized CBAM declarant must submit an annual CBAM declaration in accordance with CBAM Art. 6 and, pursuant to CBAM Art. 22, surrender the amount of CBAM certificates corresponding to its grey emissions.

1. Initial CBAM Declaration

Pursuant to CBAM Art. 6, each authorized CBAM applicant must submit a CBAM declaration via the CBAM registry by 31 May of each year. This is intended to ensure the effective application of the CBAM by verifying the number of CBAM certificates based on the information provided.²⁰

2. CBAM Certificates

CBAM certificates form the core of the CBAM and pursue the same objective as the EU ETS by pricing certain greenhouse gas emissions.²¹ Pursuant to CBAM Art. 20, para. 1, CBAM certificates are sold by EU Member States via a central common platform to authorized CBAM applicants based in the respective EU Member States. The prices of CBAM certificates are calculated by the EU Commission in accordance with CBAM Art. 21, para. 1 and are the average of the closing prices of the EU ETS allowances on the auction platform for each calendar week.


¹⁷. CBAM IR Art. 16.

¹⁸. CBAM Art. 36, para. 2, lit. (b).

¹⁹. CBAM Art. 25, para. 1.

²⁰. CBAM Recital 61 *et seq.*

²¹. CBAM Recital 20.



The reason for determining the average weekly price for CBAM certificates is to ensure that the prices of the EU ETS allowances auctioned daily are reflected as accurately as possible and that the administrative burden is minimized.²² As pricing begins on 1 January 2026, approved CBAM applicants must surrender the number of CBAM certificates corresponding to their grey emissions from imported goods for the previous calendar year by 31 May of each year from 2027 in accordance with CBAM Art. 22, para.1.

(1) Offsetting of CO2 prices paid in third countries and free allocation

CBAM Art. 9, para. 1 gives CBAM applicants the option of reducing the number of CBAM certificates to be surrendered by considering the effective carbon prices actually paid in the stated countries of origin for grey emissions. This serves to ensure that goods are treated equally in terms of carbon pricing, irrespective of different mechanisms in different countries. This may include taxes, fees, or levies in addition to any relevant emissions trading.²³ As evidence, CBAM applicants must keep records of available refunds or other available forms of compensation (see CBAM Art. 9, para. 2).

(2) Inventory, repurchase, and cancellation

It is important to note that, according to CBAM Art. 22, para. 2, each authorized CBAM applicant must ensure that the number of CBAM certificates in its account in the CBAM registry at the end of each quarter corresponds to at least 80% of the grey emissions associated with all goods that it has imported since the beginning of the calendar year.

However, it is not advisable to make precautionary purchases of CBAM certificates that significantly exceed the required amount, as the EU Commission cancels all CBAM certificates purchased in the year prior to the previous calendar year and remaining in the CBAM registry accounts as of 1 July of each year without compensation.²⁴

(3) Comparison with EU ETS

It is striking that, despite the CBAM being modelled after the EU ETS, the EU ETS' characteristic cap-and-trade principle has not been adopted: the CBAM does not set an upper limit on the total number of CBAM certificates to be issued, nor is it possible for applicants to trade CBAM certificates.

3. Enforcement and Penalties

(1) Enforcement by EU Commission

The EU Commission reviews CBAM declarations and thereby takes on a supervisory function, per CBAM Art. 19. To ensure the effective application of the CBAM, the EU Commission also carries out risk-based checks of

^{22.} CBAM Recital 49.

^{23.} European Commission, guidance document on CBAM implementation for installation operators outside the EU, Section 6.10, p. 159.

^{24.} CBAM Art. 24.

the data and transactions recorded in the CBAM registry in accordance with CBAM Art. 15, para. 1.

(2) Penalties

If an authorized CBAM applicant does not surrender the number of CBAM certificates corresponding to the associated grey emissions from goods imported in the previous year by 31 May of each year, a penalty may be imposed (CBAM Art. 26, para. 1, sentence 1). The penalty corresponds to the penalty for exceeding emissions under the EU ETS and CBAM Art. 26, para. 1, sentence 2, in conjunction with EU ETS Art. 16, paras. 3 and 4, and thus amounts to EUR 100 for each ton of CO₂ equivalent emitted by the installation for which the notifier has not surrendered certificates, increased in accordance with the European Consumer Price Index.

Both the obligation to surrender the number of CBAM certificates outstanding in a specific year and the corresponding penalty remain in place (CBAM Art. 26, para. 3). Finally, CBAM Art. 26, para. 2 provides for penalties for persons who bring goods into the EU customs territory without CBAM authorization and thus do not fulfil the obligations of the CBAM. These penalties amount to three to five times the aforementioned penalty and are determined on the basis of the duration, severity, scope, intentionality, and recurrence of the offence, as well as the violator's degree of cooperation.

These penalties are imposed by the competent national authority (in Germany, by the German Emissions Trading Authority (Deutsche Emissionshandelsstelle, DEHSt)) in accordance with CBAM Art. 26, para. 4 in conjunction with CBAM Art. 11, para. 1.

(3) Comparison with EU ETS

The penalties under the CBAM correspond to those under the EU ETS insofar as an authorized CBAM notifier fails to make the required submission (see CBAM Art. 26, para. 1).²⁵ However, if a violation is committed by a non-authorized CBAM declarant, the latter is subject to the penalty under CBAM Art. 26, para. 2 due to the lack of comparability with the EU ETS.

VI Calculation of Grey Emissions and Documentation Requirements

For the reporting obligation during the transitional phase and for the CBAM certificates to be submitted later, the grey emissions associated with goods must be calculated in accordance with CBAM Art. 7, para. 1, sentence 1 using the procedure set out in CBAM Annex IV, whereby a distinction must be made between simple and complex goods.

To verify compliance, a CBAM declarant must keep detailed records of the information required to calculate grey emissions in accordance with CBAM Art. 7, para. 5 in conjunction with CBAM Annex V and retain them until the end of the fourth year following the year in which the CBAM declaration was to be submitted in accordance with CBAM Art. 7, para. 6.

²⁵ CBAM Recital 26.

VII Evaluation and Outlook

Companies face enormous administrative and legal requirements: In addition to detailed recording and documentation of all information relating to imported goods and the calculation of the (grey) emissions associated with them, the roles of the actors involved must be determined as soon as possible so that the notification obligation and the reporting obligations, which already began on 1 October 2023, can be fulfilled. Companies also should examine how emissions can be reduced both in the product range and throughout the supply chain to minimize the CBAM's impact on their business.

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