

Implementation of the EU's Carbon Border Adjustment Mechanism and its Implications

Recently introduced by the European Union (“EU”), the Carbon Border Adjustment Mechanism (“**CBAM**”) is applicable to imports into the EU from ‘third countries’ (i.e., non-EU countries) with the broad objective of reducing carbon emissions and promoting the EU’s climate-related goals. Long before [adopting the CBAM in May 2023](#), the EU had launched the world’s first carbon market in 2005 and implemented an [Emissions Trading System](#) (“**ETS**,” and the EU’s ETS, “**EU ETS**”).

For an overview of carbon credits and the carbon market, see our note [here](#). For an overview of India’s [Carbon Credit Trading Scheme, 2023](#) (“**CCTS**”), including with respect to the EU ETS, see Issue 2 of 2023 of our Quarterly Roundup on Clean Energy (“**Newsletter**”) [here](#) (*‘Overview and Analysis’*, pp. 1 – 10). For a discussion on amendments to the CCTS, see Issue 4 of 2023 of our Newsletter [here](#) (pp. 4 - 6). For a discussion on pathways to navigating carbon taxes, see our note [here](#) (pp. 4 - 5).

The EU ETS requires polluters to pay for their greenhouse gas (“**GHG**”) emissions. The EU ETS [applies](#) to all EU member states, the European Free Trade Association countries (Iceland, Liechtenstein and Norway), and Northern Ireland for electricity generation.

WHAT IS CBAM?

Like the EU ETS, the [CBAM endeavors to impose a fair price](#) on carbon, and specifically, on the carbon emitted during the production of carbon-intensive goods that are imported to the EU. By ensuring that a price is paid for such embedded carbon emissions, the CBAM aims to make the carbon price of imports equivalent to that of domestic production. Thus, in essence, the CBAM is a measure to impose tariffs on imports from countries which do not appropriately impose such price on the production and supply of carbon-intensive goods.

Phases and timelines

A staggered rollout comprising two main stages has been envisaged for the CBAM, including for the purpose of (i) phasing out free allowances allocated under the EU ETS, and (ii) facilitating preparedness and a stable transition.

Transitional phase (October 2023 - December 2025)

The CBAM [entered into its transitional phase on October 1, 2023](#) and is set to end on [December 31, 2025](#). During this phase, the CBAM applies to imports of certain goods and selected precursors whose production is carbon intensive and at most significant risk of ‘carbon leakage’ (i.e., when EU-based companies move carbon-intensive production to countries with climate policies that are less stringent than those in the EU, or when EU products get replaced by more carbon-intensive imports). Covered products relate to the following sectors (“**Applicable Sectors**”):

- Cement
- Iron and steel
- Aluminium
- Fertilizer
- Electricity
- Hydrogen

The goal of this initial transitional phase is to serve as a pilot and learning period for stakeholders (importers, producers, and public authorities), as well as to collect relevant information on embedded emissions for the purpose of methodological refinement in the subsequent ‘definitive’ period (see below).

During the transitional phase, while covered/in-scope importers are required to report the GHG emissions embedded in their imports on a quarterly basis, they need not make any financial adjustments by buying and surrendering CBAM certificates. Relevant data needs to be collected by declarants from their suppliers and submitted to the EU authority in the form of a CBAM report. However, such data need not be verified (in the transitional phase).

The [Implementing Regulation](#), published in August 2023 (“**Implementing Regulation**”), along with its accompanying guidance, provides details on the above reporting requirements and methodology (such methodology, the “**EU Method**”). In this regard, the European Commission (“**Commission**”) has updated two guidance documents to help [importers](#) and [installation operators outside the EU](#) to navigate the transitional period. During such initial phase, the Implementing Regulation offers

flexibility with respect to values used for calculating the embedded emissions on imports.

Until the end of 2024, companies had the choice of reporting in three ways: (a) full reporting according to the EU Method; (b) reporting based on an equivalent method ([which meets the standards prescribed under Article 4\(2\) of the Implementing Regulation](#)); and (c) reporting based on [default reference values](#) (until July 2024). Default values play a specific role in CBAM implementation during the transitional period, particularly when importers do not have all necessary information. The default values for the transitional period of the CBAM, published in December 2023, are available [here](#).

However, from January 1, 2025, the EU Method alone will be accepted with respect to reporting. For complex goods, estimates (including default values) can be used only if they account for less than 20% of the total embedded emissions.

Definitive phase (from January 2026)

A review of the CBAM's transitional phase will be concluded by the Commission before the definitive regime enters into force. This review would also include the product scope of the CBAM to assess the feasibility of including other goods, including those produced in other sectors (*i.e.*, beyond Applicable Sectors) covered by the EU ETS, such as certain downstream products (*e.g.*, screws and bolts and similar articles of iron or steel) and those identified as suitable candidates during negotiations (*e.g.*, the addition of organic chemicals and polymers would add around 800 products to the CBAM's scope). The report stemming from such review will include a timetable setting out the inclusion of such goods/products by the year 2030.

While the Commission will assess whether other products are to be included in the fully operational CBAM before the end of the transitional period, when fully phased in, the CBAM will capture more than 50% of the emissions in sectors covered by the EU ETS. By 2030, the CBAM is supposed to cover all products covered by the EU ETS.

The definitive regime of the CBAM will apply from January 1, 2026. In this fully operational period, declarants need to [purchase CBAM certificates at the end of each quarter](#) (covering the value of at least 80% of GHG emissions embedded in their CBAM Annex I goods in that quarter) and verify the data collected from their suppliers. The cost of CBAM certificates is based on the weekly average of the EU ETS allowance price. There is no limit on the number of CBAM certificates that can be purchased.

After verification by independent verifiers (who are accredited according to the Implementing Regulation), the relevant data needs to be submitted annually (on May

31 each year) in the form of a CBAM declaration. The declaration is required to cover the preceding calendar year – e.g., the first CBAM declaration, which will be due on May 31, 2027, needs to include information relating to the 2026 calendar year about (i) the quantity of goods (in tonnes)/ electricity (in megawatt-hours) imported into the EU, (ii) the total embedded GHG emissions in such imports, (iii) the number of CBAM certificates to be surrendered through the Commission’s registry (calculated after deducting the net cost paid for GHG emissions in the country of origin of the goods/ electricity), and (iv) copies of verification reports issued by accredited verifiers.

If applicable, declarants may be able to claim a reduction in the number of certificates to be surrendered for the carbon price paid in the relevant country of origin.

Toolkit and resources

The Commission has developed the [CBAM transitional registry](#) to help importers perform and report on their CBAM obligations. Access to such registry needs to be requested through the [National Competent Authority](#) (NCA) of the Member State in which the importer is established. The latest version of the user manual for declarants with respect to the CBAM transitional registry was released in October 2024 and is available [here](#).

Further, the Commission has developed a ‘CBAM Self Assessment Tool for Importers to the EU’. This tool enables importers to the EU to get an overview on (i) whether their imported goods are subject to the CBAM during the transitional period, (ii) what the CBAM reporting requirements for that particular type of good are, and (iii) where to find further information.

In addition, a list of frequently asked questions (“**FAQs**”), along with answers to such FAQs was last updated on October 24, 2024 and is available [here](#).

Action items for companies

For the purpose of preparing for the CBAM, as preliminary measures, companies should:

1. Assess their individual exposure to the CBAM
2. Evaluate the availability and quality of relevant data in respect of the CBAM from their suppliers
3. Establish internal governance processes that ensures compliance with the rules of the CBAM

EVALUATING THE CBAM

While the primary stated goal of the CBAM is to support the EU's [Fit for 55](#) agenda (*i.e.*, reducing net GHG emissions by at least 55% by the year 2030 compared to 1990 levels as [part](#) of the [European Green Deal](#)), the CBAM also aims to enforce [competitive parity](#) for domestic production in the EU.

Although the CBAM has been mainly presented as a climate measure, it may also end up operating as a unilateral trade restrictive measure [designed to protect EU production](#). However, international trade law specifically seeks to [prohibit](#) attempts to restrict global trade.

Several nations, including India, the US, and China, have [labeled](#) the CBAM as protectionist. The so-called BASIC group of countries (Brazil, South Africa, India and China) has been notably critical about the CBAM, [including recently](#) at the 29th session of the Conference of the Parties ([COP29](#)) to the United Nations Framework Convention on Climate Change ([UNFCCC](#)).

While the implications of the CBAM appear to be global and diverse, certain countries, including developing and newly industrialized nations, such as those in the BASIC group, have claimed that they will be the [worst affected](#). In general, the [international reaction](#) to the EU's CBAM has been [mixed](#): while some countries may introduce their own carbon border levies (*e.g.*, the UK, Australia), others may choose to enter into bilateral agreements with the EU (*e.g.*, Canada) or change their domestic ETS (*e.g.*, South Korea). On the other hand, certain countries have openly called the CBAM discriminatory (*e.g.*, South Africa), raised concerns within the World Trade Organization (WTO) (*e.g.*, China), and/or considered initiating retaliatory measures (*e.g.*, India).

IMPLICATIONS FOR INDIAN IMPORTERS AND INDIA'S RESPONSE

The CBAM's financial obligations for exporters are premised on the carbon emissions during the production process. This means that exporters which use less carbon-intensive production methods are likely to [gain trade competitiveness](#) at a global scale. Relatedly, carbon-intensive, hard-to-abate sectors (*e.g.*, the Applicable Sectors) are likely to [suffer increased compliance costs](#).

For instance, the CBAM's compliance requirements are expected to [pull down the profits of Indian steel exports](#) to the EU by USD 60-165/MT between 2026 and 2034. The CBAM may also have a negative effect on the economic performance of entities operating within India's [Energy-Intensive and Trade-Exposed \(EITE\) industries](#).

manufacturers from key trade-exposed industries (including from within the Applicable Sectors and those that are energy-intensive) are poised to incur a significant increase in fuel costs, leading to a decrease in earnings from exports. Taken together, carbon-intensive goods exported from India to the EU are expected to face an [additional 25% tax burden](#) under, and on account of, the CBAM – which is equivalent to 0.05% of India's GDP.

While India has discussed [retaliatory measures](#) on EU exports, it is also pursuing the option of getting India's [CCTS recognized by the EU](#) and [aligning it](#) with the CBAM. Given that the CCTS is a market-based mechanism to support energy transition, and since CBAM considers the carbon price in the country of origin, the [CCTS may allow](#) Indian exporters to claim at least partial credit equivalent with India's domestic carbon price.

Separately, the EU and India are [engaged in talks](#) on a proposed Free Trade Agreement (“FTA”) between them, in the course of which India has [raised concerns](#) about the CBAM being similar to non-tariff barriers that can impede their FTA negotiations.

THE WAY AHEAD

The CBAM is likely to result in significant decline of exports into the EU from developing countries such as India. Moreover, developed countries are likely to have less carbon-intensive production processes relative to emerging economies. An [UNCTAD report](#) suggests that the EU could consider relaxing some of the CBAM's requirements for developing countries, and instead, use the revenue generated through the CBAM to assist such developing countries to adopt cleaner methods of production for the future. Among other things, this approach can foster a more inclusive trading system.

On the other hand, the CBAM could offer potential synergies, including in terms of [green hydrogen](#) partnerships and [increased renewable energy deployment](#) – both of which are consistent with India's own goals. Other than implementing the CCTS, India may find it worthwhile to build global technological cooperation to facilitate the transfer of sustainable production methods from other countries. In addition, [India may seek](#) to negotiate exemptions with regard to its proposed FTA with the EU, especially in respect of micro, small, and medium enterprises (“MSMEs”) for the purpose of insulating Indian MSMEs from expansive trade restrictions under the CBAM.

At the level of manufacturing, Indian producers and exporters could view the CBAM as an opportunity to scale up their sustainability-driven practices, including to enhance

their positioning and differentiation in a competitive market. Going forward, while carbon reporting and emissions monitoring will be essential, Indian companies should also consider investing in appropriate R&D, including with respect to emerging technologies such as Carbon Capture Utilization and Storage (CCUS).

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