Assessing the impact of the EU's CBAM on U.S. businesses

EU Carbon Border Adjustment Mechanism

The proposal for the establishment of a Carbon Border Adjustment Mechanism (CBAM) was formally submitted by the European Commission on July 14, 2021, as part of its "Fit for 55" package of legislative proposals designed to help meet the European Union's (EU) ambitious climate goal of cutting greenhouse gas emissions by 55 percent by 2030.

Designed in compliance with World Trade Organization (WTO) rules and other international obligations of the EU, the purpose of the CBAM is to ensure the increased exposure of EU businesses to carbon prices does not result in carbon leakage, whereby sourcing or production moves to other jurisdictions with a lower cost of carbon. The CBAM is established to regulate greenhouse gas emissions embedded in certain covered goods, upon their importation into the customs territory of the European Union, in a way that is broadly neutral with the impacts on EU businesses of changes to the EU Emissions Trading Scheme.[1]

The CBAM does this by imposing a charge on the embedded carbon content of certain imports from countries and territories outside of the customs territory of the EU[2] that is equal to the charge imposed on the production of domestic goods under the EU ETS.[3] Adjustments are made to this charge to take into account any mandatory carbon prices effectively paid in the country of origin that is recognized by the EU, and free allowances provided under the EU ETS to facilities producing competing goods. EU importers of the specified covered goods will, therefore, need to purchase CBAM certificates corresponding to the carbon price that would have been paid on the imported goods, had the goods been produced under the EU's carbon pricing rules. The purchase price of CBAM certificates will be the average of the closing prices of auctioned EU ETS allowances on the common auction platform for each calendar week (expressed in €/tonne of CO2 emitted).

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[1] These changes include a significant reduction in the aggregate emissions limits associated with the EU ETS, which are increasing the carbon price within the EU, and a gradual phase out of free permits provided to heavy emitting industries (including all those producing products covered by the CBAM).

[2] Excluding Iceland, Lichstenstein, Norway, Switzerland, and five other minor territories.

[3] The EU ETS, which currently applies to limited energy-intensive, high emitting industries, is 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.

Covered goods include:

Cement	Electricity	Fertilizer	Iron and steel	Aluminum	Hydrogen

Importers of covered goods (except electricity) will need to have the embedded emissions of their products calculated according to the established EU methodologies and independently verified. Where goods are imported from countries that have mandatory carbon prices, the number of CBAM certificates required to be surrendered may be reduced in line with carbon costs already paid. The U.S. has no internal carbon price mechanism, so U.S. industries will be subject to the CBAM. The scope also includes indirect emissions under certain conditions, certain precursors, and some downstream products (such as screws and bolts and similar articles of iron or steel) in these covered sectors. By 2025, the products subject to CBAM will be reviewed to assess whether the scope should be extended to include other goods at risk of carbon leakage, including organic chemicals and polymers, with the intention that all goods covered by the ETS will be included in the CBAM scope by 2030. The review will also include an assessment of the methodology for indirect emissions and the possibility to include more downstream products.

The CBAM would be gradually implemented. CBAM will begin to operate from October 1, 2023 onwards with a transitional phase, whereby affected organizations/importers will only be required to fulfill reporting obligations. Exporting third-country producers should provide embedded emissions information during the transitional phase. The aim for this first phase is to collect data.

From January 2, 2026, financial obligations will take effect. Importers will have to be registered in the CBAM registry and start purchasing CBAM certificates. Embedded emissions data submitted by exporting third-country producers must be verified by an independent, accredited verifier.

Impact timeline

Preparation period

- Before October 1, 2023
- Review the scope and determine the impact of CBAM
- Check data availability

Transitional period

- October 1, 2023–December 31, 2025
- Reporting without paying, only reporting obligations
- CBAM report quarterly
- Financial impact and monitor scope

Final period

- January 1, 2026 and further
- Authorization
- Certification
- Calculation and verification
- Declaration and deduction

How does this impact U.S. businesses?

The reforms could significantly impact global exporters throughout the supply chain. Business leaders across the U.S. must begin preparation efforts to measure, report, and reduce their carbon footprint as part of the larger climate risk management strategies.

For the U.S. businesses exporting goods to the EU that are subject to the CBAM, as an immediate step, they should assess the impact of the proposed CBAM regulations and start preparing for the reporting obligations that will take effect from October 1, 2023. The following must be taken into consideration to prepare for the impact of this legislation:

- **Assess their own carbon emissions**: Businesses will need to determine the carbon footprint across production operations to remain competitive in the global market as the demand for decarbonized production increases.
- **Consider carbon reduction strategies**: Businesses may consider implementing carbon reduction strategies such as investing in renewable energy, improving energy efficiency, and reducing waste.
- **Review the global supply chain**: Businesses will need to determine the origin of products, any direct or indirect embedded carbon in the product, whether the company is ultimately an exporter of covered goods, and whether there are any pricing or supply chain risks as a result.
- **Implement internal systems**: Businesses should start to consider the implementation of internal systems, internal controls, and carbon accounting to track and report data to EU importers. If a U.S. business cannot provide adequate actual embedded emissions data, then the EU will use its proposed "default" calculation method for the purpose of determining emissions, which contains a number of punitive assumptions.
- **Assess market impacts**: The CBAM reforms are occurring alongside major changes to EU firms, which are facing significant increases in carbon prices. Competitive advantage will increasingly depend on the relative carbon efficiency of business products produced inside and outside the EU. This has implications for business and environmental, social, and governance (ESG) strategies.

How can KPMG help?

KPMG services that can support these efforts include the following service lines:

- **Tax Credits, Grants, and Incentives**: With the enactment of the Inflation Reduction Act, U.S. companies are being incentivized to reduce their carbon footprint and are well positioned to produce clean goods in the global market. The KPMG Tax Credits, Grants, and Incentives team is composed of local teams and national specialists with a deep knowledge of these industry and tax issues. These teams can help bring a fresh perspective on planning opportunities and assist in obtaining and monetizing potential tax benefits.
- **Value Chain Management and Supply Chain Sustainability**: The KPMG Value Chain Management practice can help companies develop effective supply chains from the ground up, integrating tax into the overall business processes to help enhance long-term savings.
- **Advisory Accounting Services**: KPMG member firms' Accounting Advisory Services practice comprises a dedicated team providing accounting and financial reporting advice and support to member firms' audit and nonaudit clients on a wide range of transactions and events, including adherence to new or revised accounting standards and effective management of the financial reporting processes.
- **Climate Policy Advisory**: KPMG has a network of global specialists to assist U.S. companies understand policy evolution in destination countries that impact on them and their competitors, to assist firms in optimizing business and ESG strategies in light of this rapidly changing global environment.
- **Verification of emissions**: KPMG Cert GmbH is an accredited verification body, accredited by German DAkkS (Deutsche Akkreditierungsstelle) with many years of experience in EU-ETS verification services.

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