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## Carbon Border Adjustment Mechanism – UK Consultation Response

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On October 30 the Labour government confirmed in its response to a consultation that the UK would introduce a Carbon Border Adjustment Mechanism or CBAM.<sup>1</sup> The previous Conservative government had initiated two rounds of consultation:

- an exploratory consultation in spring 2023 to consider policies aimed at mitigating carbon leakage<sup>2</sup> (the movement of the carbon-intensive production of goods – in this case from the UK – to other countries to avoid the costs of climate change policies); and
- a further consultation on the detailed policy design and implementation of a UK CBAM in spring 2024, to which the new government has now responded.<sup>3</sup>

In introducing a CBAM the UK would be following the EU, which enacted a CBAM in May 2023 (see our previous [Energy Transition Insights memo](#) for more details).

### UK CBAM

The UK CBAM will impose a levy on the import into the UK of certain goods that are at risk of carbon leakage. This levy is designed to reflect the UK's carbon price on greenhouse gas emissions embedded into the production of the goods. The goal is to ensure that imported carbon-intensive goods pay a carbon price comparable to what would have been payable had they been produced in the UK, thus levelling the playing field between domestic and imported goods.

The UK CBAM will only apply to imports of specified goods (so-called CBAM goods) within five sectors: aluminium; cement; fertilisers; hydrogen; and iron & steel. The consultation originally suggested that the UK CBAM also apply to the glass and ceramics sectors, but the government has now announced that these will not be included at first, as they present a lower risk of carbon leakage. Nonetheless, the government will continue to review the scope of the UK CBAM and these sectors may be included at a later date.

The UK CBAM will apply to both 'direct' and 'indirect' emissions to ensure alignment with the UK Emissions Trading Scheme. 'Direct' emissions are emissions related to the production processes of CBAM goods;

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'indirect emissions' refer to the emissions related to the production of the electricity consumed during these production processes. The UK CBAM will apply to certain 'precursor' goods: these are CBAM goods which are used as inputs into the production processes of other, more complex CBAM goods. The consultation response does not provide any detail on what specific processes will be included when determining direct and indirect emissions, or how these different types of emissions will need to be monitored, reported and verified. These details will be outlined later.

### Other Key Considerations

- **The UK CBAM will come into effect on January 1, 2027.** There will be no preparatory period in which importers are subject to reporting requirements but no tax is due. Those affected by the CBAM should use the time from now until 2027 to prepare for implementation and start engaging with their overseas suppliers to maximise the time available to obtain actual emissions values for their imports.
- **Liability will fall on the person responsible for the goods when they are released into free circulation.** The person responsible for submitting returns and paying the UK CBAM levy to HMRC – the 'liable person' – will be either the person responsible for the goods when they are released into free circulation or, where there are no customs controls, the person on whose behalf the goods are moved to the UK.
- **Default emissions values will be available.** The liable person will be able to calculate the levy using actual emissions data which have been independently verified or using default emissions values set by the government. These ensure that the levy can be paid even if actual emissions data are unavailable. The consultation response did not outline how these default values will be calculated.
- **There is a minimum registration threshold of £50,000 of CBAM goods that pass the tax point over a 12-month period.** Businesses importing less than £50,000 worth of CBAM goods within a 12-month rolling period (looking back on a monthly basis) will not be subject to the UK CBAM unless at any time they expect to import more than that amount within the next 30 days. This threshold has been increased from the £10,000 threshold proposed in the consultation earlier this year (and the lookback is no longer daily).
- **There will be seven rates of tax: one for each sector.** These rates will be applied per tonne of embodied emissions. The government will set them on a quarterly basis, taking into account the price of allowances under the UK Emissions Trading Scheme, the free allocation of allowances under the UK ETS and the Carbon Price Support mechanism (which tops up the carbon price paid for generating electricity using fossil fuels). The government promised to publish more detail about how the rates will be set in due course.
- **Liability can be reduced if verified carbon prices have already been paid abroad.** A liable person may be able to receive a tax credit if CBAM goods have already been subject to an explicit carbon price overseas. This tax credit will be equal to the carbon price amount paid. If a CBAM good is subject to multiple carbon prices, the combined total of these carbon prices can be used to offset UK CBAM liability.
- **Many details regarding the UK CBAM are yet to be confirmed.** The consultation response has left several key details outstanding (and recognises this). On top of the points already mentioned, the government is yet to decide:
  - whether accounting periods from 2028 will remain annual like the 2027 period or become quarterly (as the consultation proposed); and
  - whether group registration would be feasible.

## Further Consultation

This response document concludes the formal consultation process, but the government will continue to engage with both domestic and international stakeholders through the establishment of a CBAM industry working group and a UK CBAM international group to engage with other governments. It has also promised to publish the draft legislation for stakeholder comment ahead of its introduction in Parliament.

## Alternative Policies

As discussed in a previous S&C Memo, the 2023 consultation considered two other potential measures against carbon leakage in addition to a UK CBAM: the introduction of mandatory product standards and additional demand-side policies. It has since been announced that there is no intention to proceed on either of these alternative measures.

## INTERNATIONAL CONTEXT

The UK CBAM will come into effect one year after the EU CBAM becomes fully operational on 1 January 2026.<sup>4</sup> The two regimes are conceptually very similar and look to achieve the same goal of levelling the playing field between imports and domestic products. Differences between the two regimes include the following:

- **Mechanic.** The EU CBAM requires importers to purchase and surrender “CBAM certificates” (similar to allowances under the EU ETS) for the embedded emissions they report (after subtracting amounts to reflect free allowances under the EU ETS and an adjustment for the effective carbon price paid outside the EU on production of the goods). As explained above, the UK CBAM will not be based on certificates: instead, payments under the UK CBAM will be levied as a tax charge to be paid directly to HMRC. This is likely to be easier to administer, since a system of certification would require additional machinery. Moreover, the EU CBAM model (where CBAM certificates are priced at weekly average EU ETS market prices) would not fully reflect the effective UK carbon price, which includes the Carbon Price Support and the Energy Intensive Industry compensation scheme.
- **Product scope.** The EU CBAM includes electricity, but the UK CBAM does not.
- **Emissions covered.** Both the EU and UK CBAMs cover all direct emissions but diverge on indirect emissions. The EU CBAM currently covers indirect emissions arising from electricity consumed during the production process only for cement and fertilisers, whereas the UK CBAM covers indirect emissions for all sectors in scope.
- **Reporting periods.** The EU CBAM has an annual reporting period; although this will also be the case for the UK CBAM for 2027, it may change to quarterly reporting periods from 2028.

The UK and EU are not alone in their desire to address carbon leakage through the introduction of a CBAM. The Australian government is currently undertaking a carbon leakage review and consulting on the possible introduction of a CBAM, particularly in relation to steel and cement.<sup>5</sup> The Canadian government is also consulting on the possible introduction of Border Carbon Adjustments.

In contrast some states (including India) have expressed objections to CBAMs and similar measures and have talked of challenging the EU CBAM at the World Trade Organization.

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**ENDNOTES**

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- 1 His Majesty's Revenue & Customs and His Majesty's Treasury: Introduction of a UK Carbon Border Adjustment Mechanism from January 2027: Government response to the policy design consultation, October 30, 2024. See full text [here](#).
- 2 Department for Energy Security and Net Zero and His Majesty's Treasury: Addressing carbon leakage risk to support decarbonisation: A consultation on strategic goals, policy options and implementation considerations, March 30, 2023. See full text [here](#).
- 3 His Majesty's Revenue & Customs and His Majesty's Treasury: Introduction of a UK carbon border adjustment mechanism from January 2027, March 21, 2024. See full text [here](#).
- 4 Regulation (EU) 2023/956 of the European Parliament and of the Council of May 10, 2023, establishing a carbon border adjustment mechanism. See full text [here](#).
- 5 Australian Government Department of Climate Change, Energy, the Environment and Water: Carbon Leakage Review: Consultation Paper 2, November 2024. See full text [here](#).

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Questions regarding the matters discussed in this publication may be directed to Max Birke, June Hu, Craig Jones, Andrew Thomson or any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. Additional S&C resources about energy transition matters may be found [here](#). This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice.