The world's first carbon border-adjusted tax enters its definitive phase: What it means for Canada

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On January 1, 2026, the European Union (EU) formally launched the world's first carbon border levy. After a transitional period of over two years and a flurry of additional legislation required to operationalize the levy in late 2025, the EU's Carbon Border Adjustment Measure (CBAM) is now in full force.

Critics have disparaged CBAM for the costs imposed on producers outside of the EU and labelled it as a protectionist measure. For the EU, CBAM has two principal objectives: it is, to be sure, the central tool to address carbon leakage concerns; CBAM is also critical as an industrial policy measure to "level the playing field" for EU industries subject to strict domestic carbon pricing regimes. So, not *quite* protectionist, but also not *purely* a climate change tax. Barring further significant upheavals to global trade in the future - a perilous qualification these days – CBAM is anticipated to expand in scope rather than contract in the coming years.

With financial costs of CBAM's implementation arriving in 2027, some importers may be tempted to view the coming year as a grace period. That would be a mistake. As importers of subject goods began to accrue liabilities under the program as of January 1, they should take immediate steps to establish the necessary emissions tracking regimes, as well as revisit pricing structures to avoid bearing undue costs.

Background

The absence of a global carbon pricing mechanism creates the risk that production of carbon intensive goods is shifted from jurisdictions that price carbon emissions to those that do not. This "carbon leakage" erodes competitive neutrality and disadvantages domestic producers subject to carbon pricing mechanisms in the form of taxes, regulation or market-based solutions. For a detailed policy discussion on global carbon pricing and its implications for Canada, see our earlier insight.

To address carbon leakage and ensure competitive neutrality – that is, a "level playing field" – for EU producers, the European Commission (EC) introduced the CBAM. As implemented, importers of highly carbon-intensive imports (steel and iron, aluminum,

cement, fertilizer, electricity, and hydrogen) that are captured by the measure are required to:

- obtain authorization as a “CBAM declarant”;
- report embedded emissions quarterly; and
- purchase and surrender CBAM certificates annually.

The framework requires importers to either:

- track and disclose
  - direct emissions from the production process, *and*
  - in some cases, indirect emissions, **or**
- apply default values established under CBAM. The values are typically conservative and may result in punitive values in the absence of sufficient reporting systems.

Pricing of CBAM certificates will be determined according to weekly average auction prices of EU Emission Trading System (ETS) allowances. To achieve the policy intent under CBAM, the cost of CBAM certificates should be incorporated into prices that importers ultimately charge to domestic EU customers in order to achieve the desired “level playing field”.

Importantly, CBAM allows importers to account for carbon pricing measures imposed in source countries by reducing the CBAM charged on imports that have already been subject to the application of a carbon price mechanism, though partial or complete equivalency of specific mechanisms remains uncertain at this time.

What this means for imports originating from Canada

CBAM has major legal, economic, and strategic consequences for Canadian exporters, regulators, and policymakers as we seek to diversify our trade relationships by expanding exports to the EU.

The concern raised by other major trading parties such as the U.S., China, and India is that CBAM will impose costs on exporters and is likely to increase trade frictions. This is true for increased costs associated with CBAM certificates, making exports less competitive, as well as increased compliance and reporting requirements that will impose indirect costs on exports to the EU.

For Canada and Canadian exports, the impact of CBAM is both sector specific and widespread.

As a major exporter of aluminum to Europe, Canadian exports of these goods will be subject to CBAM. Of course, Canadian producers—especially in Québec—benefit from low-carbon electricity, giving them a potential competitive advantage under CBAM. This advantage may well create growth opportunities for Canada’s low-carbon metals sector, enabling it to gain market share over more carbon-intensive competitors.

With respect to Canadian-sourced fertilizer, the EU is considering exemptions for fertilizers due to concerns about rising costs for farmers. If fertilizers remain within

scope for CBAM, Canadian nitrogen fertilizer exporters may face higher compliance burdens as a result of fertilizer production being energy-intensive.

More broadly, CBAM is likely to put additional pressure on the Canadian government to harmonize Canada's carbon pricing strategy and potentially pursue equivalency with EU measures.

In March of 2025, the Canadian government effectively eliminated the federal consumer carbon tax by decreasing the federal Fuel Charge rates to zero per cent. The industrial Output Based Pricing System (OBPS) remains intact and would likely apply to manufacturers of goods within the current scope of CBAM.

But as with everything Canadian and anything that touches the environment, *it's complicated*. Canada's provincial carbon pricing systems vary.

Recall that the *Greenhouse Gas Pollution Pricing Act* in that it operates as a carbon "backstop". It allows provinces to chart independent but equivalent carbon pricing measures. This approach is perfectly in line with "cooperative federalism", a major principle in Canadian division of powers, and the principle of "subsidiary" – a hallmark of Article 5 of the Treaty on European Union. But it also means that benchmarking of Canada carbon pricing system to the EU may be difficult. How the EU considers the equivalency of the federal OBPS, the Alberta *Technology Innovation and Emission Reduction Regulation* (TIER) and Québec's cap-and-trade system, remains uncertain.

What is certain, is that Canadian exporters to the EU will face increased administrative and compliance burdens to comply with CBAM, which may disproportionately affect smaller and medium sized exporters. Not only will exporters be required to track and verify embedded emission and provide detailed emissions data to EU importers, parties will also be required to closely monitor evolving carbon pricing regimes outside the EU to identify offset opportunities. This may also require further alignment with EU methodologies and new measurement, reporting and verification systems.

Divergence between U.S. and EU approaches could also further complicate North American supply chains that have been subject to significant upheaval in the last 12 months.

Looking forward

The EC has stated its intention that CBAM will continue to form its primary tool to address carbon leakage, signaling that the scope of goods subject to CBAM requirements is likely to increase. On December 16, 2025, the EC published proposals to expand CBAM to include 180 steel and aluminum intensive downstream products, starting in 2028. This trend is expected to continue as EU legislators pursue carbon leakage down the supply chain.

Canadian policy makers are expected to closely monitor the EU's implementation of CBAM, given the federal government had consulted on a Canadian CBAM as early as 2021, and recent policy discussions suggest growing interest in mirroring the EU approach to protect domestic industries. By monitoring the EU's rollout, Canada can better assess potential impacts on domestic industries, identify best practices, and

determine how similar tools could support Canada's own climate competitiveness objectives.

Takeaways

The EU's CBAM represents a major shift in the intersection of climate policy and international trade. For Canada, the mechanism presents both challenges and opportunities. While some sectors, particularly low-carbon aluminum and steel, stand to benefit, others may face increased compliance costs and competitive pressures. Legally, CBAM places pressure on Canada to maintain and potentially strengthen its carbon pricing system, while also accelerating discussions about implementing a Canadian CBAM. As the EU moves toward full implementation in 2026, Canadian exporters and policymakers must prepare for a new era in climate-aligned trade regulation.

BLG's international trade and tax teams are here to help Canadian manufacturers and exporters across the country navigate the increasingly choppy waters of international climate change measures.

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