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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC and Decision (EU) 2015/1814 as regards driving competitiveness and cost-effective decarbonisation and Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2015/757 and Regulation (EU) 2023/1805 to simplify and streamline monitoring, reporting and verification and to align with revisions of the EU Emissions Trading System - Policy debate

In view of the Council (Environment) on 12 October 2026, a background paper from the Presidency with questions to Ministers on the proposals is contained in the [Annex](#).

The [Committee of Permanent Representatives](#) is invited to take note of the background note and to forward it to the Council.

EU Emissions Trading System Review**- Policy debate -**

- Presidency background paper with questions for Ministers -

I. BACKGROUND

The EU Emissions Trading System (ETS) was launched in 2005 and has remained a global standard setter, with 41 similar systems in place covering 26% of global emissions. The Directive has seen multiple revisions since its adoption to ensure alignment with the EU's overall climate ambition.

On 17 July 2026, the European Commission submitted the above-mentioned legislative proposals as part of the EU ETS 1 Revision. The revision aims to modernise the ETS 1 system in view of the EU's 2040 climate goals set out in the EU Climate Law while increasing investments in decarbonisation of industry, ensuring its long-term competitiveness.

On 24 April 2026, the Presidents of the European Parliament, Council and Commission signed a Joint Declaration committing to achieve the 'One Europe, One Market Roadmap'. Within this, Leaders committed to a successful completion of the EU ETS 1 revision by Q1 2027. To facilitate this, the Irish Presidency is aiming to achieve a General Approach at the December Environment Council.

II. STATE OF PLAY, OVERVIEW OF KEY ELEMENTS OF PROPOSALS

Since the publication of the Commission's proposals, the Presidency has organised Working Party meetings and in addition some informal videoconferences with the participation of experts from capitals. At the start of the process, the Presidency divided the proposals into thematic blocks to facilitate focused discussions given their broad nature.

Member States are making progress on some elements of the review already and the Presidency is aiming to issue a first compromise text on those less contentious aspects after the Environment Council on 12 October 2026.

However, the Presidency has identified three key areas where views diverge widely and where Ministerial guidance would be particularly beneficial at this time. A summary of the proposed changes within these key areas are provided below along with guiding questions.

a. Overall trajectory of ambition

i) Linear Reduction Factor

The Commission has proposed to slow the annual reduction of the overall cap on allowances (Linear Reduction Factor) and to continue to issue allowances into the 2040s. The Commission has stated it is designed to be aligned with the EU-wide 2040 target including with the use of international carbon credits. The proposal updates the Linear Reduction Factor from 4.4% to 3.7% for 2031-2035, with the introduction of a slower decrease in a second period 1.7% from 2036-2040 depending on the availability of international carbon credits. If insufficient credits are available, this will be automatically readjusted to 2.7%. The Commission will publish a report assessing the availability of such credits by 31 January 2033.

ii) International Credits

Up to 260Mt of international carbon credits may be purchased to contribute to EU ETS emissions reductions targets from 2036-2040. These will be funded by the auctioning of up to 260 million allowances, purchased and managed by a centralised purchasing facility. The proposal requires such credits to be high quality, high integrity and cost-effective, with the full details of the credits available upon the adoption by the Commission of a separate legislative proposal.

iii) Domestic Permanent Carbon Removals

In line with the EU-wide 2040 target, the proposal intends to incorporate domestic carbon removals into the EU ETS. As with international credits, there would be centralised purchasing, with the intention to auction 250 million allowances from 2031 to 2040 to generate revenue for the purchasing of an equivalent amount of domestic permanent removal units (from domestic permanent biogenic emissions capture with carbon storage (BioCCS) and Direct Air Carbon Capture and Storage (DACCS) technologies certified under the EU Carbon Removal Certification Framework). A review clause is in place for December 2034 to examine, amongst other things, nature-based removals.

iv) Free Allocation Extension and Carbon Border Adjustment Mechanism (CBAM)

For sectors considered at risk of carbon leakage, the Commission proposal extends free allocation from 2030 to 2040. Free allocation from 2031 would be conditional on investment in decarbonisation in the EU.

The proposal further aims to reduce carbon leakage risk by slowing down CBAM phase-in from 2034 to 2038. For CBAM sectors, the CBAM factor (the rate at which free allocation is reduced) is amended.

b. Distribution and use of funds

A significant number of allowances under the EU ETS are auctioned, generating revenues which are used both directly by Member States and indirectly through reinvestment into EU funds such as the Innovation Fund and the Modernisation Fund. The Innovation Fund supports the demonstration and early commercialisation of innovative low-carbon technologies, while the Modernisation Fund supports the modernisation of energy systems and improvements in energy efficiency for lower-income Member States.

i) Use of Member State auction revenues

The Commission proposes to introduce the principle that more national revenues should flow back to ETS1 sectors and amend how Member States use auction revenues to tackle climate change with the introduction of priority spending categories. Member States would be required to allocate at least 50% of ETS revenues to support decarbonisation in ETS1 sectors, in particular, in areas of industrial decarbonisation, clean energy, electricity grids, waste decarbonisation, low-carbon transport and research and innovation. The remaining 50% continues to be used for climate purposes more broadly.

The proposal would prohibit spending which risks fossil-fuel lock-in in power generation. It also strengthens visibility and reporting obligations, requiring Member States to make the use of ETS funding more visible through common communication requirements and the use of standardised EU branding.

ii) Industrial Decarbonisation Bank (IDB) and Investment Booster (IB)

The purpose of the IDB is to scale up and deploy decarbonisation technologies for industry through supporting capital investment costs (including electrification, grid connection, energy storage and flexibility costs) and operational costs resulting in emission reduction or removals.

During the first phase (2028-2030), 400 million allowances will be reserved to the IB from unused allowances of Phase 4. During the second phase (2031-2040), the IDB funding (400 million allowances from phase 5) will be administered primarily through competitive bidding.

The IB (2028-2030) aims to fast-track investments with a ‘first in, first served’ system, providing a fixed carbon premium for a period of maximum 10 years (paid in the form of allowances) to make industrial decarbonisation investments bankable.

Projects in all Member States may be eligible for the IDB. 100 million allowances will be ringfenced specifically for lower GDP Member States (<75% of the Union average between 2022-2024). After 18 months, this reserve reduces to 60 million allowances.

iii) Innovation Fund

The proposal extends the Innovation Fund beyond 2030 and allocates 50 million allowances until the end of 2030, and 200 million allowances from 2031 to 2040. The Fund may provide support in different forms, including grants, competitive bidding, and contributions through instruments such as InvestEU. The Commission proposes to increase transparency in open calls for proposals, with screening criteria including: need for broad sectoral and geographical coverage, SME participation, and synergies with other support instruments.

iv) Modernisation Fund

The aim of the Fund is to support energy system modernisation, efficiency and industrial decarbonisation in lower-income Member States. The Commission proposes to redistribute 2% of the cap to lower-income Member States, with a further 0.5% of the cap that beneficiary Member States can use to support industrial decarbonisation in their country through the IDB instrument, while making it more targeted:

- 95% minimum spending on priority investments;
- No fossil-fuel lock-in;

- Eligibility updated to 12 Member States based on a GDP market of <75% of the EU average (2022-2024 data); and
- Strengthened application of rule of law conditionality and strengthened transparency in use of funds.

In addition, the proposal retains the redistribution of 10% of auction volume as part of the redistribution efforts to enhance solidarity and foresees that lower-income Member States use their share through the Modernisation Fund.

c. Sectoral scope

i) Aviation

Aviation was first brought within the scope of the EU ETS in 2012. Under the system, aircraft operators are required to monitor, report and verify their carbon dioxide emissions and surrender allowances corresponding to those emissions. The aviation ETS currently applies to all airlines on flights within the European Economic Area (EEA), as well as flights between the EEA and Switzerland and the United Kingdom, while the EU ETS also implements the International Civil Aviation Organization's Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) on relevant international routes.

In addition to implementing CORSIA, the proposal retains the current aviation ETS scope (flights within the EEA; flights between the EEA, CH and the UK) for 2027 and introducing an expansion from 2029 to 2032. Under this approach, from 2029 the ETS would apply to flights departing the EEA and arriving at certain third-country destinations located within 5,000 kilometres of Frankfurt, as well as all private jet flights contributing from 2028. An additional 110 million allowances from the extended scope are introduced to support the EU ETS' Sustainable Aviation Fuel (SAF) Support Mechanism [for all departing flights from the EEA from the same date in 2029]. Member States may also top-up this mechanism. It also amends the eligibility criteria under which aircraft operators can qualify for supports, by introducing restrictions in relation to where the SAF is produced. The proposal also removes the current distinction between commercial and non-commercial aircraft operators for ETS coverage purposes, thus bringing more business aviation operators within the scope of the system.

ii) Maritime

The Commission proposal revises the current treatment of offshore vessels, moving to an ‘activity’ rather than ‘vessel’ based approach for operations and voyages serving EU waters and worksites, and also seeks to expand the scope to small vessels of certain ship types between 400 and 5,000 gross tonnage. MRV requirements would apply from 2029, with ETS then applying from 2031 with the resulting cap increase generating allowances to be attributed to SMAP support.

The Commission proposes that the additional revenue be used for measures supporting decarbonisation investments in the maritime sector, top-up of the SMAP mechanism, and administrative expenses for implementation of the EU ETS.

Existing maritime derogations are extended from 2030 until the end of 2035 for small islands, outermost regions, transnational public service contracts or obligations, and ice-class vessels, with a new derogation in the surrendering obligations for large container vessels involved in transshipment activity also proposed as a complementary measure to further tackle the risk of evasion and enhance a greater level-playing field relative to neighbouring non-EU ports.

iii) Waste

The current Directive required that the Commission consider the inclusion of municipal waste incineration in EU ETS from 2028 (with potential opt-out to 2030). The Commission now proposes fully including municipal waste incineration activities with a capacity exceeding 3 tonnes per hour, through a gradual phase-in from 1 January 2031 reaching 100% of verified emissions coverage by 2034 and onwards. Co-incineration of waste and non-municipal non-hazardous waste incineration was already covered under the "combustion of fuels" activity. Hazardous waste (and chemical recycling) remains excluded. Monitoring, reporting and verification will be extended to landfill emissions in parallel, while the upcoming Circular Economy Act plans to strengthen complementary landfill policies. Derogations are permitted until 2035 for outermost regions, as well as for Member States meeting at least two of three conditions. Dedicated support is provided for local authorities’ waste management measures through the priority use of national ETS revenues, and for (co-)incineration installations through the different ETS Funds.

The inclusion of municipal waste incineration downstream is interconnected with the provisions in the proposal incentivising the upstream capture of carbon for utilisation.

III. QUESTIONS FOR THE DEBATE

The European Parliament, Council and Commission have collectively committed, through the One Europe, One Market Roadmap, to an ambitious deadline for the successful conclusion of the revision. In this context, Ministers are invited to assess progress and give guidance on the way forward recognising the impact changes may have on the overall balance of the proposal. The following questions may aid interventions:

1. *The proposal updates the ambition of the EU ETS by amending the trajectory for reduction in allowances, and introducing the use of international carbon credits and domestic permanent carbon removals. Do you view the structure of the ambition as the right one to achieve our agreed 2040 target?*
2. *The proposal places an increased emphasis on targeted funding to support the continued decarbonisation of ETS 1 industrial sectors, while also addressing broader climate, energy and social needs and ensuring continued solidarity among Member States. Does the proposed funding framework and extension of free allocation (including for CBAM sectors) strike the right balance in supporting industrial decarbonisation and competitiveness, addressing the broader challenges, and providing sufficient flexibility for Member States? Which elements should be potentially adjusted to improve this balance?*
3. *The proposal expands the scope of the ETS 1 with regards to the aviation, maritime and waste sectors, with the stated aim of incentivisation and increased support for decarbonising these sectors. Do you have any priority issues with regards to the scope changes?*