

EU Taxonomy Regulation: key takeaways from the new FAQs

On 19 December 2022, the European Commission published two draft notices containing frequently asked questions (FAQs) to aid in the interpretation and implementation of certain legal provisions under the Taxonomy Regulation. In our previous [note](#), we looked at some of the FAQs' main features, which we now consider in greater detail below.

Background

The Taxonomy Regulation is a transparency tool that sets out harmonised criteria for determining whether an eligible economic activity qualifies as environmentally sustainable. The Taxonomy regulation also includes a disclosure obligation at Article 8 (the **Article 8 disclosure obligation**), which applies to entities which are already required to include a non-financial statement in their management report under the Non-Financial Reporting Directive (**In-scope Entities**).

The Article 8 disclosure obligation requires In-scope Entities to include information on how and to what extent their activities are associated with taxonomy-aligned economic activities in their non-financial statements. Article 8 applies to both financial undertakings (i.e. asset managers, credit institutions, investment firms, insurance undertakings or reinsurance undertakings) and non-financial undertakings that qualify as In-scope Entities.

The details of the key performance indicators or KPIs to be used by In-scope Entities are set out in a delegated act (the Article 8 Delegated Act, which we summarised [here](#)).

TSC FAQs

The first notice (the **TSC FAQs**) sets out responses to FAQs on the technical screening criteria (**TSC**) for the Taxonomy's first two environmental objectives of climate change mitigation and climate change adaptation. These TSC were set out in the Climate Delegated Act, which has applied since 1 January 2022. The TSC FAQs cover:

- Horizontal Questions on the interpretation of the TSC generally, and which are not limited to a particular economic activity;
- Sector Specific Questions on the TSC on the interpretation of TSC for specific economic activities, within sectors including forestry, energy and construction; and
- Questions on recurring DNSH criteria on the interpretation of the “do no significant harm” test.

Among the clarifications provided in the answers to the horizontal questions are:

- The Commission, advised by the Platform on Sustainable Finance, will regularly review the TSC for both substantial contribution and DNSH, which may as a result become more strict;
- The Climate Delegated Act prioritized the inclusion of economic activities with the highest potential to make a substantial contribution to GHG emission reductions, however further activities may be added in the future;
- The validation of certain TSC (forest management plans are given as an example) requires specialist knowledge and therefore include specific external validation requirements. For these activities, the report by the external verifier is sufficient evidence of compliance;
- The Article 8 disclosure obligation applies to all entities in scope of the NFRD and all of their activities, including those carried on outside of the EU. In order to determine alignment, an undertaking should determine if these non-EU activities are carried out in line with the applicable EU legislation, or (if referred to in the TSC), a relevant international standard or equivalent third-country law.

Disclosures FAQs

The second notice (the **Disclosures FAQs**) sets out responses to FAQs on the Article 8 disclosure obligation, as set out in the Disclosures Delegated Act.

The Disclosures FAQs were published shortly before Non-financial undertakings are due to begin reporting their KPIs on Taxonomy alignment, and therefore much of the notice is concerned with the Turnover, Capex and OpEx KPIs which these undertakings will use. The Commission states that it may publish a further notice on the Green Asset Ratio (GAR) and the Green Investment Ratio (GIR) which Financial Undertakings will begin reporting as of 1 January 2024.

The Disclosures FAQs contains 34 FAQs, divided between general FAQs, and FAQs specific to the Turnover, CapEx and OpEx KPIs. We have set out below a summary of certain of these FAQs:

General FAQs

What is the timeline for the Complementary Delegated Act?

The Complementary Delegated Act amended the Disclosures Delegated Act and the Climate Delegated Act, to introduce specific nuclear energy and fossil gas related economic activities into the EU Taxonomy. On the basis that these amendments become effective from 1 January 2023, non-financial undertakings should disclose the eligibility, non-eligibility, and alignment of these activities as of that date, in relation to the 2022 financial year. Financial undertakings will only be required to report the eligibility of such activities until 31 December 2023, with alignment following in 2024.

What is the timeline for the remaining four environmental objectives?

So far, there have been no TSC for the four environmental objectives of (i) sustainable use and protection of water and marine resources; (ii) transition to a circular economy; (iii) pollution prevention and control; and (iv) protection and restoration of biodiversity and ecosystems, which were due to become effective on 1 January 2023. On the basis that disclosure is dependent on the existence of the TSC, these four objectives, will not be in scope for reporting in 2023.

What impact will the CSRD have on the scope of the reporting entities under the Disclosures Delegated Act?

The phased implementation of the CSRD has raised some questions about the timing of the expansion of the entities in scope of reporting under the Taxonomy, since the Taxonomy population is defined by reference to the Accounting Directive, and in particular by those provisions which were introduced by the NFRD and which will be replaced by the CSRD. The Disclosures FAQs set out a useful timeline, as follows:

- financial years starting from **1 January 2024** (publication from 2025) – the scope remains as under the NFRD;
- financial years starting from **1 January 2025** (publication in 2026) - large undertakings and parent undertakings of a large group – ie the public interest entity and 500 employee criteria will fall away;
- financial years starting from **1 January 2026** (publication in 2027):
 - listed SMEs excluding micro-undertakings;
 - small non-complex institutions; and
 - captive reinsurance undertakings.
- financial years starting from **1 January 2028** (publication in 2029) - third-country undertakings with significant operations in the EU.

How can entities ensure that voluntary reporting does not contradict or misrepresent mandatory disclosures?

The Disclosures FAQs note that voluntary reporting can include both (i) entities subject to eligibility reporting disclosing their anticipated alignment; and (ii) reporting by entities not subject to any obligation under the Taxonomy. Both entities are advised to disclose the basis on which the voluntary disclosures have been prepared, and entities who are disclosing both mandatory and voluntary information should make clear how the two differ, as well as ensuring that the voluntary information is not given more prominence, and that it does not contradict or misrepresent the mandatory information, in line with previous guidance from the Platform.

Comparative Information

The FAQs clarify that, although the Disclosures Delegated Regulation provides that KPIs should be disclosed along with those from the previous year, this will not apply in the first year of reporting – which is 2023 for non-financial undertakings (relating to 2022) and 2024 for financial undertakings (for 2023).

Consolidation

The Disclosures Delegated Regulation provides that a non-financial undertaking should provide its KPIs at the individual level where it prepares individual non-financial statements or at group level where it prepares consolidated non-financial statements. Whether an undertaking prepares its non-financial statement at individual or group level is determined by the NFRD, which provides that a given firm should prepare its own statement unless it is included in its parent's statement, which rule applies up through the chain of ownership. On this basis when preparing consolidated KPIs, a parent should include:

- All of its subsidiaries (including non-EU); and
- All of its activities and assets (including non-EU).

Turnover KPI

As regards the turnover KPI, the FAQs confirm that:

- Where an undertaking recognises revenue generated by a subcontractor as its own revenue under the applicable accounting principles, it should be included within the turnover KPI; and
- The turnover KPI records external sales only, and does not include economic output which is internally consumed.

CapEx KPI

As regards the CapEx KPI, the FAQs confirm that all CapEx, irrespective of the source of the funding, should be included within the CapEx KPI.

The Disclosures Delegated Act provides that a non-financial undertaking should include within the numerator of the CapEx KPI any capital expenditure which is part of a plan to expand Taxonomy-aligned economic activities or to allow Taxonomy-eligible economic activities to become Taxonomy-aligned. This is defined as **a CapEx plan** and is subject to certain conditions, including that it must be limited in time to a five year period (which may be extended to 10 years) and it must also be approved by the undertaking's management body. In this regard, the FAQs confirm that the time period commences from when the CapEx plan is approved internally. The FAQs also provide some further details on the level of precision required from a CapEx plan in order for it to be eligible.

The FAQs confirm that where an asset that the CapEx is financing can be used for various projects, it is necessary to only allocate the proportion of CapEx which is effectively assisting Taxonomy-aligned economic activities, in order to avoid greenwashing. In order to do so, reporting entities should use a non-financial metric that provides for an accurate allocation of the CapEx to a Taxonomy-aligned activity. These disclosures must also be accompanied by contextual information.

OpEx KPI

The FAQs confirm that, where research and development cannot be linked to specific Taxonomy-aligned activities, it may not be accounted in the numerator of the OpEx KPI. On the other hand, if research and development is used for both Taxonomy-aligned and non Taxonomy-aligned activities, then it should be included in the numerator of the OpEx KPI based on its pro-rata contribution to the Taxonomy-aligned activities.

Conclusion

Both sets of FAQs provide important clarifications on the timing and requirements of reporting under the Taxonomy Regulation, which will be useful for financial and especially non-financial undertakings preparing for reporting in 2023. The TSC FAQs in particular provide detailed guidance which should be checked by undertakings making disclosures in respect of the relevant economic activities.

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