

The EU Taxonomy Regulation: Key Issues and State of Play

12 February 2025

The EU Taxonomy Regulation (the “Taxonomy” or “Taxonomy Regulation”) is the EU classification system for environmentally sustainable economic activities.

The EU Platform on Sustainable Finance (the “Platform”), an advisory body to the European Commission (the “Commission”), published in January 2025 a [Compendium of Market Practices](#) on use of the Taxonomy, and in February 2025 published a [report](#) on key areas to improve and simplify the Taxonomy Regulation. We discuss in this In Depth the current key questions under the Taxonomy and the extent to which the Platform’s recent work addresses these.

The information in this In Depth, particularly in relation to the scope of companies reporting under the Corporate Sustainability Reporting Directive (“CSRD”), may change in light of the Commission’s proposed reform of the sustainability reporting framework, due to be announced later this month (the so-called “Simplification Omnibus package”).

Taxonomy Regulation and Taxonomy Delegated Acts

The [Taxonomy Regulation](#) sets out six environmental objectives, namely: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.

Delegated Acts specify the particular environmentally sustainable economic activities which the EU currently regards as making a substantial contribution to those objectives and define the technical screening criteria which the activities must meet to be Taxonomy-aligned. The Delegated Acts produced to date are:

- the [Climate Delegated Act](#), which contains technical screening criteria for activities substantially contributing to the environmental objectives of climate change **mitigation** and climate change **adaptation**. This has been amended to include

nuclear and gas energy generation activities which contribute to these two objectives.

- the [Environment Delegated Act](#), which contains technical screening criteria for activities substantially contributing to the environmental objectives of:
 - the sustainable use and protection of water and marine resources;
 - the transition to a circular economy;
 - pollution prevention and control; and
 - the protection and restoration of biodiversity and ecosystems.

Separately, the [Disclosure Delegated Act](#) supplements the Taxonomy by specifying the content and presentation of Taxonomy-related information which a company in scope of CSRD must disclose.

In broad terms, the Taxonomy includes screening criteria for the following activities:

- forestation;
- renewable energy generation and related storage and technology;
- heavy manufacturing with low emissions;
- energy generation from gas with low emissions;
- energy generation from nuclear energy;
- transport and infrastructure with low emissions;
- construction and renovation of buildings with low emissions;
- related professional and IT solutions;
- sustainable water supply and waste management;
- sustainable plastic and electronic manufacturing;
- second-hand goods;

- some pharmaceutical activities;
- hazardous waste disposal; and
- habitat restoration.

The majority of these activities are covered under the climate change mitigation and adaptation objectives, with fewer activities covered under the biodiversity, circular economy, water use and pollution prevention objectives.

The Taxonomy has limited coverage of transition activities, which are sectors that are not currently sustainable but can substantially improve their environmental profile through investment. Examples include the renovation of existing buildings and operation of electricity generation facilities using fossil gaseous fuels that have plans in place to reduce carbon intensity, which contribute to climate change mitigation and adaptation. We discuss this in more detail in a separate [Debevoise In Depth](#).

An asset manager engages with the Taxonomy either in the context of the commitments it makes for its funds under the [Sustainable Finance Disclosure Regulation](#) (“SFDR”) or under [CSRD](#). CSRD requires companies in scope to report on the Taxonomy alignment of their activities. Companies need to identify which activities (such as power generation, energy intensive manufacturing or energy storage) are both Taxonomy-eligible (capable of being aligned with the Taxonomy) and Taxonomy-aligned, in each case under the technical screening criteria, and break down those activities by annual turnover and, if relevant, capital expenditure (“CapEx”) and operating expenditure (“OpEx”). An asset manager will assess Taxonomy alignment by reference to the activities of its investee companies in scope of CSRD, not by reference to its own activities. An asset manager will report this information only by reference to its investee companies which themselves report under CSRD and its exposure to loans or bonds issued for the purpose of financing Taxonomy-aligned activities, in line with the EU’s [Green Bond Standard](#), applying from December 2024, or under a similar private framework. This is regardless of whether the bond issuer is itself in scope of CSRD. Proceeds of bonds aligned with the EU’s Green Bond Standard are expected to be invested in economic activities aligned with the Taxonomy either directly by financing “real economy” expenditure or indirectly by creating additional equity or debt instruments which themselves finance real economy expenditure.

Large public interest companies in scope of CSRD will report on their Taxonomy alignment, using the templates in the Disclosure Delegated Act for 2024 reporting periods in 2025, whilst other large companies will report in 2026 for 2025 reporting periods. Non-EU companies that are subject to the worldwide reporting obligation under CSRD from 2028 are not required to include reporting on Taxonomy alignment,

although non-EU companies reporting on a consolidated level in respect of both their EU and non-EU operations may include Taxonomy information to exempt their EU subsidiaries from their sustainability reporting obligations. In its [February 2025 report](#), the Platform recommends various simplifications to the templates by reducing or combining the number of fields.

In its separate, [January 2025 report](#), the Platform published recommendations for revisions to the Taxonomy technical screening criteria. The recommendations include adding several new activities, including the provision of digital solutions and services and production of materials such as lithium, nickel and copper, and the revision of certain technical screening criteria in the Climate Delegated Act to improve usability, in particular by simplifying the “do no significant harm” (“DNSH”) criteria.

To What Extent Do Funds Invest in Alignment with the Taxonomy?

A crucial use of the Taxonomy is in “green” financial products. This includes funds that are classified under Article 8 of SFDR, which are funds that broadly promote environmental or social characteristics, and funds classified under Article 9 of SFDR, which are funds that invest only in sustainable investments and which may commit to invest in a proportion of Taxonomy-aligned investments. In practice, only funds that invest in fields that are covered by the Taxonomy, in particular in renewable energy and low emissions manufacturing and infrastructure, have tended to commit to invest a proportion of their portfolio in Taxonomy-aligned activities. However, all funds that promote environmental characteristics must include in their periodic reporting, regardless of initial commitments, information on Taxonomy alignment in their portfolio, to the extent reliable data is available. Whilst different approaches are possible, most sponsors to date which have not committed to a proportion of their portfolio as Taxonomy-aligned have only reported on the Taxonomy alignment of their portfolio where an investee company is in scope of and reporting under CSRD. For private fund sponsors, that has resulted in a limited amount of reporting on Taxonomy alignment, although sponsors are aware that, from 2026, many unlisted EU companies will report Taxonomy alignment data, which may need to be included in SFDR periodic reports.

What Are the Key Challenges to Qualify an Asset Under the Taxonomy?

Many companies have found the technical screening criteria to be complex to apply, with the criteria for the DNSH test, which can include up to 20 criteria in some cases, particularly challenging. As the Platform notes, DNSH criteria can be more easily considered upfront for new projects, but can be difficult to assess retrospectively. In other words, whilst companies can report CapEx aligned to the Taxonomy where they have implemented the DNSH criteria during the construction or upgrade of an asset and incorporated those criteria in contracts dealing with the construction or upgrade, an

investor may not be able to obtain data to assess compliance against the criteria when acquiring an already constructed asset.

DNSH criteria are either:

- based on thresholds (such as acceptable emission levels);
- require particular safeguards to be in place, such as environmental mitigation measures covered by EU law-required environmental impact assessments; or
- require compliance with EU legislation or international standards.

Other DNSH criteria state ambitions in general terms without any clear reference point, such as a technical solution for emission reduction that demonstrates “substantial life-cycle GHG emission savings compared to the best performing alternative solution”.

In its February report, the Platform recognises these practical difficulties, encouraging the Commission to adopt clear and objective criteria with “pass/fail” outcomes in place of more general criteria. Separately, the Platform suggests, when aligning turnover against the Taxonomy, to allow companies to use the DNSH criteria on a “comply or explain” basis, allowing companies not to apply the criteria where the assessment is too challenging to make retrospectively, with suitable justification. If adopted, this would be a significant simplification.

Although the Commission regularly reviews the technical screening criteria, it is inevitable that some criteria become out of line with the current state of science and technology. In addition, the EU has published guidance that addresses some points of uncertainty, for example, [November 2024 FAQs](#) on technical questions on the criteria and activities included under the Environmental and Climate Delegated Acts. However, companies may find that different consultants have different interpretations.

It may be possible for investors to assume that certain criteria, such as those relating to compliance with EU law, have been met in the ordinary conduct of business through the existence, for example, of ESG practices, absent evidence to the contrary. It is unclear, however, whether smaller entities or projects may disregard certain DNSH criteria in view of, for instance, their limited relevance to the actual environmental risks posed.

For flexibility, where data is lacking, the Platform recommends that companies may use estimates to assess DNSH criteria based on, for instance, the absence of prior controversies.

How Do Financial Undertakings Report on Taxonomy Alignment?

As above, a financial undertaking, including an asset manager, which is in scope of CSRD will assess Taxonomy alignment by reference to its investee companies which report under CSRD and its exposure to loans or bonds issued for the purpose of financing Taxonomy-aligned activities.

We describe the process for asset managers to report on Taxonomy alignment under CSRD in a separate [Debevoise In Depth](#). The Platform refers to an asset manager's proportion of investments in Taxonomy-aligned activities as its "Green Investment Ratio", a signal of its sustainability profile to investors.

As reporting under CSRD is largely limited to investments in, or loans to, companies that are subject to CSRD reporting, asset managers are expected to report low reported Taxonomy alignment figures. For example, an investor in wind or solar may in practice finance such investments through special purpose vehicles, classified as small- to medium-sized enterprises and likely out of scope of CSRD reporting. Where an investor reports a low reported proportion for Taxonomy alignment, this may not align with broader statements made of its achievements for environmentally aligned investments.

According to Commission guidance, financial undertakings may disclose information on estimates of Taxonomy alignment of their exposures in companies that are not reporting under CSRD, and the Platform report includes guidance on reporting estimated alignment figures, such as by reference to the company's corporate sustainability reporting, published policies and environmental track record.

How Should Investors Qualify the Activities of Non-EU Companies Under the Taxonomy?

The Taxonomy includes numerous references to EU standards in the fields of environmental protection, including EU labelling and certification schemes, as well as references to international standards. The Taxonomy also refers to performance to date in the EU in the context of, for instance, manufacturing activities based on the "average value of the top 10% most efficient installations in GHG performance" in Europe. There is no recognition in the Taxonomy that different regions around the world have different starting points in terms of decarbonisation.

In practice, EU fund managers may use the Taxonomy to assess the activities of non-EU companies, and EU companies are required to assess their non-EU as well as EU activities. In some cases, the DNSH criteria refer to international standards or allow the investor to use non-EU standards for activities in non-EU countries in place of EU standards. In other cases, the DNSH criteria only refer to EU standards. For instance, in the climate change mitigation criteria, in respect of the requirement to produce an EU

environmental impact assessment to ensure no significant harm to biodiversity, the technical screening criteria for activities outside the EU refer to equivalent applicable national law or international standards.

There has been longstanding uncertainty as to the extent to which companies may qualify non-EU activities as Taxonomy-aligned under equivalent non-EU standards, regardless of whether or not the technical screening criteria expressly refer to such non-EU equivalents. There is not yet any clear basis for a fund sponsor to apply equivalent national or international standards to assessing Taxonomy alignment, other than where the technical screening criteria clearly refer to non-EU equivalents. In addition, some non-EU activities will have no available data points, such as building Energy Performance Certificates, as against some DNSH criteria.

The uncertainty reflects that the EU did not set out to produce a Taxonomy with international application. The Platform's report recognises these uncertainties and recommends the Commission does further work on translating EU legislative references into quantitative or process-based criteria, where possible, and, at least in the non-EU context, allows companies to use international standards to demonstrate their compliance. However, challenges will remain, in part because international standards are subject to change and will be further complicated as other countries develop their own environmental taxonomies in the future. In that regard, the International Platform on Sustainable Finance published a "[Common Ground Taxonomy](#)" in November 2024, comparing respective sustainable finance taxonomies between the EU, China and Singapore. However, it is likely that the practical difficulties that arise when applying the Taxonomy to non-EU companies will continue to exist.

How Do Companies Determine Whether Their Activities Are Covered by the Taxonomy?

There are essentially two methods for a company or its investor to determine whether the activities are covered by the Taxonomy. The first is to collect data on the business activities carried on by the company by reference to the Statistical Classification of Economic Activities in the European Community ("NACE"), and to then use the [NACE Code/Taxonomy](#) mapping tool published by the Platform to determine which of those activities are covered. The second is to use the overview of activities listed under the Taxonomy technical screening criteria in the [EU Taxonomy Compass](#), which lists all sectors (and activities within that sector) that are covered by the Taxonomy.

While some projects can be relatively easy to link to the economic activities listed in the Taxonomy, others, such as large-scale infrastructure, will have components which may relate to the same or different environmental objectives in the Taxonomy as well as having social components.

In addition, some NACE codes link to more than one Taxonomy activity. For example, NACE code “C25” corresponds to several activities which make a substantial promotion to climate change mitigation, including manufacture of renewable energy technologies and manufacture of other low-carbon technologies. Moreover, some Taxonomy activities have no NACE codes—for example, preparation for reuse of end-of-life products and product components, which makes a substantial contribution to the environmental objective of pollution prevention and control.

Does the Taxonomy Distinguish Between Core and Incidental Activities?

The focus of the Taxonomy is the alignment of a company’s core business activities—those which generate the majority of its turnover—with the Taxonomy and reporting on the proportion of the company’s annual turnover which is Taxonomy-aligned. CapEx and OpEx linked to Taxonomy-aligned activities are also reported. In that regard, the EU has confirmed that the Taxonomy is also relevant to companies that are not active in the sectors listed in the EU Taxonomy Compass, stating that CapEx, for instance, by any business in its buildings to reduce their energy consumption may be in scope. This is an important point, as it requires all companies to consider whether Taxonomy reporting is relevant to their CapEx and OpEx.

The Platform’s report points out that where a company is required to produce Taxonomy reporting, it cannot currently disregard small amounts of Taxonomy-aligned CapEx or turnover on the basis of a materiality threshold. The Platform proposes a materiality threshold that will exempt companies from reporting where only a limited portion of their activities (such as small CapEx on refurbishing a building) is in scope of the Taxonomy.

What Uncertainties Are There in Relation to the Minimum Safeguards Test?

For an economic activity to be aligned with the Taxonomy, the activity must be carried out in alignment with the OECD Guidelines for Multinational Enterprises (“OECD Guidelines”) and the UN Guiding Principles on Business and Human Rights (“UN GPs”), including the eight fundamental International Labour Organisation conventions and the International Bill of Human Rights. These standards are referred to as the “Minimum Safeguards” for social and governance matters, defined as “procedures implemented by an undertaking to ensure the alignment” with the OECD Guidelines and the UN GPs. This covers a company’s environmental and social policies, labour relations, community relations, the management of its third-party workers and suppliers, and the assessment of the environmental, health and safety, and community risk and impact of its operations. In practice, an investor’s checks will be proportionate to the types and likelihood of risks posed by the company and the information which is reasonably obtainable. In some cases, when looking at social safeguards, the existence of policies and absence of prior breaches (for example, human rights-related policies and

clean legal record) may be sufficient. However, where an investor considers that a risk is particularly acute, it may wish to perform further checks, such as looking at particular outcomes from the policy, such as actions taken against suppliers. Equally, where there is a prior breach, investors can look at the improvements the company has made in its processes.

There is some lack of clarity as to whether an investor should carry out the minimum safeguards check only in relation to the Taxonomy-aligned activity or more broadly by reference to all the activities that the company carries on. The Platform's report recommends that the checks are applied to the entity and not to a specific activity. In practice, where an investor is qualifying a substantial amount of a company's turnover under the Taxonomy, the distinction may not be important.

According to the Platform's report, sources of data for checking Minimum Safeguards are the company's non-financial reporting and published data on controversies in media and by civil society organisations, such as human rights violations.

Note that, for companies within scope of the Corporate Sustainability Due Diligence Directive ("CSDDD"), compliance with CSDDD will be treated as compliance with the OECD Guidelines or the UN GPs.

Is There a Requirement for Third-Party Assurance and Verification?

Companies in scope of CSRD will need to obtain "limited assurance" of their Taxonomy reporting. Although the Commission will adopt formal standards on limited assurance standards of CSRD reporting by October 2026, the Committee of European Auditing Oversight Bodies has published [non-binding](#) guidance in the meantime. On Taxonomy reporting, the guidance suggests that the assurance assessment will focus on identifying and assessing the risks of "material misstatements" in Taxonomy reporting, leaving some discretion as to the type of checks that assurance providers will conduct.

Otherwise, certain technical screening criteria contain specific verification requirements for certain activities, at specific intervals or more broadly on a regular basis, and a [Commission Notice](#) on interpretation and implementation of the EU Taxonomy states that external verifiers are either the relevant national competent authorities or an independent third-party verifier.

Assessment of Taxonomy alignment of activities needs to be performed annually for the purposes of reporting, either under CSRD or SFDR. As confirmed by the Commission, undertakings can reuse evidence from previous reporting years in their annual assessment if there is, for instance, no material change in environmental impact, or no change in the law governing environmental impact, for a given activity.

* * *

Please do not hesitate to contact us with any questions.



Patricia Volhard
Partner, Paris, Frankfurt,
London
+49 69 2097 5150
pvolhard@debevoise.com



Jin-Hyuk Jang
Counsel of Debevoise &
Plimpton LLP, Partner of
Debevoise & Plimpton Europe
S.à r.l., Frankfurt
+49 69 2097 5115
jhjang@debevoise.com



John Young
Counsel, London
+44 20 7786 5459
jyoung@debevoise.com



Alfie Scott
Associate, London
+44 20 7786 5478
awscott@debevoise.com



Eike Björn Weidner
Associate, Frankfurt
+49 69 2097 5220
ebweidner@debevoise.com

This publication is for general information purposes only. It is not intended to provide, nor is it to be used as, a substitute for legal advice. In some jurisdictions it may be considered attorney advertising.