

# Climate Finance Taxonomy – A greenlight for green finance

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## Introduction

Pursuant to the announcement to develop India's Climate Finance Taxonomy in the Union Budget 2024-25, the Department of Economic Affairs, Ministry of Finance, has invited expert comments on the Draft Framework for India's Climate Finance Taxonomy (Framework). The Framework chalks out the principles that will steer the Framework and prescribes the methodology for classifying activities, projects and measures that contribute to India's climate commitments, in consonance with the objectives allied with attaining *Viksit Bharat* by 2047. The Framework targets to allow greater flow of resources to climate tech and activities, enabling the country to achieve the vision of becoming 'Net Zero' by 2070, while also warranting long-standing access to reliable and inexpensive energy.

India has outlined compelling climate goals, including achieving Net Zero emissions by 2070 and fulfilling its Nationally Determined Contributions (NDCs) by 2030, which will require approximately USD 2.5 trillion.

The vital strategies to achieve the same include:

- Reducing emissions intensity;
- Increasing non-fossil fuel energy capacity;
- Expanding forest cover; and
- Promoting the 'Lifestyle for Environment' initiative.

The Framework is designed to be a dynamic, evolving 'scenario designed tool' aligned with India's developmental needs, aiming to attract investments and prevent greenwashing.

Historically, India's per capita Greenhouse Gas (GHG) emissions stood at approximately 2.9 tonnes of carbon dioxide equivalent in 2023, notably lower than the world average of 6.7 tonnes of carbon dioxide equivalent.

However, India has been consistent with its views on climate action which is defined by the commitments made through the NDC submitted to the United Nations Framework Convention on Climate Change (UNFCCC) in 2016 and its subsequent update in 2022. The NDC is focused on: (a) reducing the emission intensity of the GDP; (b) enhancing the non-fossil energy installed capacities in electric power generation; and (c) creating additional carbon sinks.

India has already undertaken many policy initiatives to steadfast its stand on climate action such as:

- The Solar Parks Scheme and Ultra-Mega Solar Power Projects to establish 40,000 MW capacity.
- PM KUSUM scheme targeting at decentralised solar deployment.
- PM Surya Ghar Muft Bijli Yojana targeting the supply of solar power to one crore households by March 2027.
- National Bioenergy Programme supports waste-to-energy, biomass cogeneration and biogas plants.
- Nuclear Energy Mission purposes to develop Small Modular Reactors (SMRs) indigenously and increase nuclear capacity to 100 GW by 2047.
- The transition to clean cooking fuel has reached near dissemination through the Pradhan Mantri Ujjwala Yojana (PMUY) in 2023-24 significantly improving energy access for households.

By introducing Production Linked Incentive (PLI) schemes for promoting the manufacturing of high-efficiency solar PV modules and enhancing the production of electric and hydrogen fuel cell vehicles, the Faster Adoption and Manufacturing of Electric Vehicles (FAME) scheme for manufacturing and marketing of electric two-wheelers, three-wheelers, four-wheelers and buses with the expansion of charging infrastructure, India continues to steer towards its 'Net Zero' goal.

Through the adoption of the Framework, India proposes to put a government validation on the sustainability of the activities recognised in the Framework.

## Objectives of the Framework:

The Framework outlines the activities which are in consonance with India's climate action targets and transition pathway. The objective is to facilitate greater resource flow to climate-friendly technologies and activities and supporting achievement of the vision to be 'Net Zero' by 2070.

The key objectives laid down in the taxonomy are as follows:

1. Mitigation: Avoiding GHG emissions and reduction in intensity of emissions while improving efficiency of energy through research and development for mitigations.
2. Adaptation: Enhancing resilience and geography-specific adaptation measures to cut the negative impacts of climate change.
3. Support transition of hard-to-abate sectors: Transition activities in consonance with the alleyway for hard-to-abate industries, innovation and research & development (R&D), will create a path for low-carbon structure considering the available technology, its access and viability.
4. Consistency with the developmental goal of 'Viksit Bharat' to be achieved by 2047.
5. Prevent 'greenwashing'.

The aspects of the climate finance in India are divided into two categories:

- (i) Qualitative: The elements to define the core principles guiding green activities and align with India's NDCs.
- (ii) Quantitative: The elements to provide measurable targets for transparency and accountability.

The hybrid approach combining the qualitative and quantitative aspects is proposed to guide the identification of activities and projects as being 'climate relevant' while being reflected in the form of performance thresholds like the expected extent of GHG savings and improvements in emission intensity. It is also pertinent to note that Framework on climate finance is be a living document and will be periodically evaluated to net the growing requirements and to progressively cover sectors, projects and activities providing promising landscape of investments for climate finance.

## Phased Implementation:

The approach will be implemented in a phased manner to enable flexibility to address technological modifications and data constraints, particularly in sectors like Micro Small and Medium Enterprises (MSMEs) and agriculture:

- (i) *Firstly*, commencing with qualitative criteria to provide a broad framework that aligns with national priorities, such as inclusive growth and sector-specific low-carbon pathways.
- (ii) *Subsequently*, the quantitative thresholds will be implemented for greater precision.

## Principles of Framework:

- A. Consistency with stated position on climate action and development priorities, by cultivating the country determined transition pathways such as Net Zero carbo emissions and *Vikas Bharat @2047* as the basis for a consistent climate finance setup.
- B. Do no significant harm to other objectives of the Framework, by ensuring that the climate finance-backed projects and policies are mastered without having a material adverse effect on the existing policies and initiatives in this regard.

- C. Focusing on pathways and trajectories in the country context, by aligning the policy and project trajectories with the specific growth pace and sectoral requirements of the country.
- D. Interoperability and consistency shall be maintained to ensure that international frameworks and taxonomies are aligned with the development priorities and national climate goals of India.
- E. Support transition activities, by facilitating a dynamic and comprehensive classification approach that supports sectors crucial for transition and facilitating investment in significant sectors during their phase of transition.
- F. Promoting the use of indigenous technologies, as the Framework aims to augment investments in indigenous technologies by incentivising the adoption of such technologies and research and development on a preferred basis.
- G. Be science-based and transparent, by relying on blatant and robust methodologies to spot investment prospects.
- H. Proportionality - support for MSMEs, by implementing the principals of the Framework in a manner where the MSME sector is not adversely impacted and a correlation and cohabitation is maintained between large scale projects and MSME initiatives, to enable even the MSMEs to get on the low carbon bandwagon.

### Approach to the classification of activities, projects and measures contributing towards India's climate commitments:

The Framework has provided for classification of activities and projects into two brackets ('*climate supportive*' and '*climate transition*') while adopting a graded approach at various levels:

- A. **Climate-supportive activities** would include the activities, projects and measures that contribute to one or more objectives set out in the policy framework, through at least one of the following:
  - Avoiding GHG emissions;
  - Reducing emission intensity;
  - Deploys adaptation solutions that reduce the risk of adverse impacts of climate change; and
  - Research and development to meet one or more objectives of the framework.

The Framework further divides the climate supportive activities into Tier 1 and Tier 2, where Tier 1 activities, *inter alia*, include activities, projects, measures lead to absolute emission avoidance, including non-fossil fuel resources and Tier 2 activities, *inter alia*, include activities, projects and measures that contribute to a reduction in emission intensity and have defined pathways for further improvement.

- B. **Climate transition activities** shall include activities, projects and measures for which there is an absence of a technologically and economically feasible low-emission alternative in the country.

### Sectoral coverage:

The Framework sets out the measures, projects and policies for governing classification related to identified sectors, since the framework is a living documents, additional sectors may be included from time to time. At present the following sectors are considered as 'key sectors':

- Power, mobility, and buildings (in the context of climate mitigation and adaptation co-benefits):
  - Power: As India progresses towards its Net Zero goals, harmonising power generation from diverse sources such as renewables, thermal, nuclear and hybrid system will be critical for sustaining economic momentum.
  - Mobility: Various government initiatives have been undertaken for a low carbon roadmap including the Emission Standards and Auto Fuel Policy of 2003, Corporate Average Fuel Economy (CAFE), Green National Highways Corridor Project (GNHCP), Faster Adoption and Manufacturing of Hybrid and Electric Vehicles (FAME) and Expansion of Metro Networks.
  - Real Estate: This sector is the backbone of the project development industry of the country and National Mission for Sustainable Habitat (NMSH) through its various policies such as Smart Cities Mission, Green Rating for Integrated Habitat Assessment (GRIHA) and the Indian Green Building

Council (IGBC) (which plays a crucial role in development while minimising energy and material consumption through design and technology).

- The agriculture sector contributes 16% of India's gross domestic product (FY24 Provisional Estimate) and employs 46.1% of the population, and accordingly, is in the highest need to adapt to climate finance.

## Success Drivers:

Since the Framework currently is open for suggestions from the public for better implementation, here are a few pointers which, in our view, may be a catalyst to achieving the success desired by adopting the Framework:

- Establishing a central body for co-ordinating and integrating the framework policies with the existing regulations issued by relevant authorities such as the Reserve Bank of India and the Securities and Exchange Board of India, to supervise and monitor greenwashing.
- Improve data infrastructure and accessibility by investing in interoperable digital platforms that enable real-time data sharing among agencies and stakeholders of the Framework.
- Issuance of policies enabling ease of foreign investment into the sectors / activities identified as 'Tier 1 climate supportive' activities.
- For sectors such as energy storage solutions mobility, wherein technology, R&D and investments have not seen a sharp upward movement, the Taxonomy could, by highlighting these sectors, steer additional capital towards such sectors.
- Subsidised rates of borrowing for banks and NBFCs and other financial institutions for offering attractive lending rates to the borrowers undertaking climate supportive activities or climate transition activities.
- Clearing of ambiguity and overlaps in the current provisions of the qualifying criteria for different activities. For example, there are similarities between the criteria for 'Tier 2 climate supportive' activities and those for 'transition supportive' ones. Having a clear and unambiguous taxonomy will ensure successful implementation and achievement of goals as set under the Framework.

## Conclusion

The utilization of green climate taxonomies is acquiring global traction and, at this juncture, the Framework lays down a strong foundation and is a step towards a better direction albeit an ambitious one. The draft blends in the principles of many global taxonomies without compromising the needs and environment of India. With further upgrades and clarifications, the Framework will give strength to its credibility and efficacy.

We understand that having a clear government-backed taxonomy not only unlocks domestic and foreign capital by bolstering the investor confidence, but can also reduce greenwashing by aiding investor confidence in identifying and labelling that their investments as 'green' investments backed by the government. The taxonomy signifies the missing link in its green transition that can transform policy ambition into tangible and significant climate action.

We expect to see a lot of positive movement in financing of MSMEs involved in climate transitions activities.

The hybrid approach under the Framework will aid in ensuring that the diverse industrial structure of India and the dynamic regulations mechanism is addressed while promoting a science-based trajectory for climate transition.

A focused and concentrated approach as laid down in the Framework will lead to increased business opportunities for project professionals and flutter of activities in the engineering procurement and construction (EPC) space.

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