

Transatlantic M&A Playbook

Insights for investors
navigating cross-border deals
in the United States

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Foreword

Mergers and acquisitions in Europe and the United States (US) present many similarities, but also exhibit key differences, mainly stemming from cultural and legal nuances. Additional variations may also exist between individual European countries.

Acknowledging the differences and understanding their impact on the process, timing, and terms of a cross-border transaction is critical to ensure thorough preparation, appropriate structuring, and smooth discussions between parties all the way to closing.

This guide explores these key differences and highlights the main considerations for European investors considering US-based assets, as well as the other way around, from the inception of a project to its completion.

The key steps of a standard M&A deal flow addressed in the following pages are preparation & negotiations, due diligence, and deal closing.

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Summary

01. Preparation and negotiations

02. Due diligence

03. Deal signing and closing

Preparation and negotiations

Several considerations can potentially impact the flow of negotiations between a seller and a buyer. These should be anticipated, and certain key questions should be addressed from the onset when contemplating an acquisition across the Atlantic.

Disclosed information and non-disclosure agreement (NDA)

A non-disclosure agreement is usually the first document signed in an M&A process. The choice of legal jurisdiction may depend on the identity of the parties and the underlying assets. In the US, parties generally prefer a state law that does not apply a duty to negotiate in good faith (e.g., Delaware law) and US trade secret owners may wish to refer to the Defend Trade Secrets Act (DTSA). Particular attention shall be paid to the drafting of the NDA when one (or both) of the parties is a listed company and the disclosed information may qualify as insider information. Seeking advice from local lawyers to properly choose applicable law and adjust drafting in the most appropriate manner is highly recommended.

Negotiations and good faith

Negotiations in Europe tend to prioritise relationship building, resulting in more formal and consultative processes. US negotiations are usually more informal and direct, focusing on deal terms.

While the obligation to negotiate in good faith is a rule of public policy under French law, and a seller is obliged to disclose in good faith all the facts necessary to enable a potential buyer to make an informed decision with respect to the contemplated transaction, English law does not recognise the same obligation (although the position seems to be changing according to recent UK case law).

In the US, the concept of negotiating in good faith can vary from one jurisdiction to another, but generally there is no duty to negotiate in good faith before a legally binding contract has been formed.

Applicable tax regime and inheritance of tax liabilities

Whether or not a buyer inherits past tax liabilities when acquiring a company is essentially dependent upon the tax regime of this company.

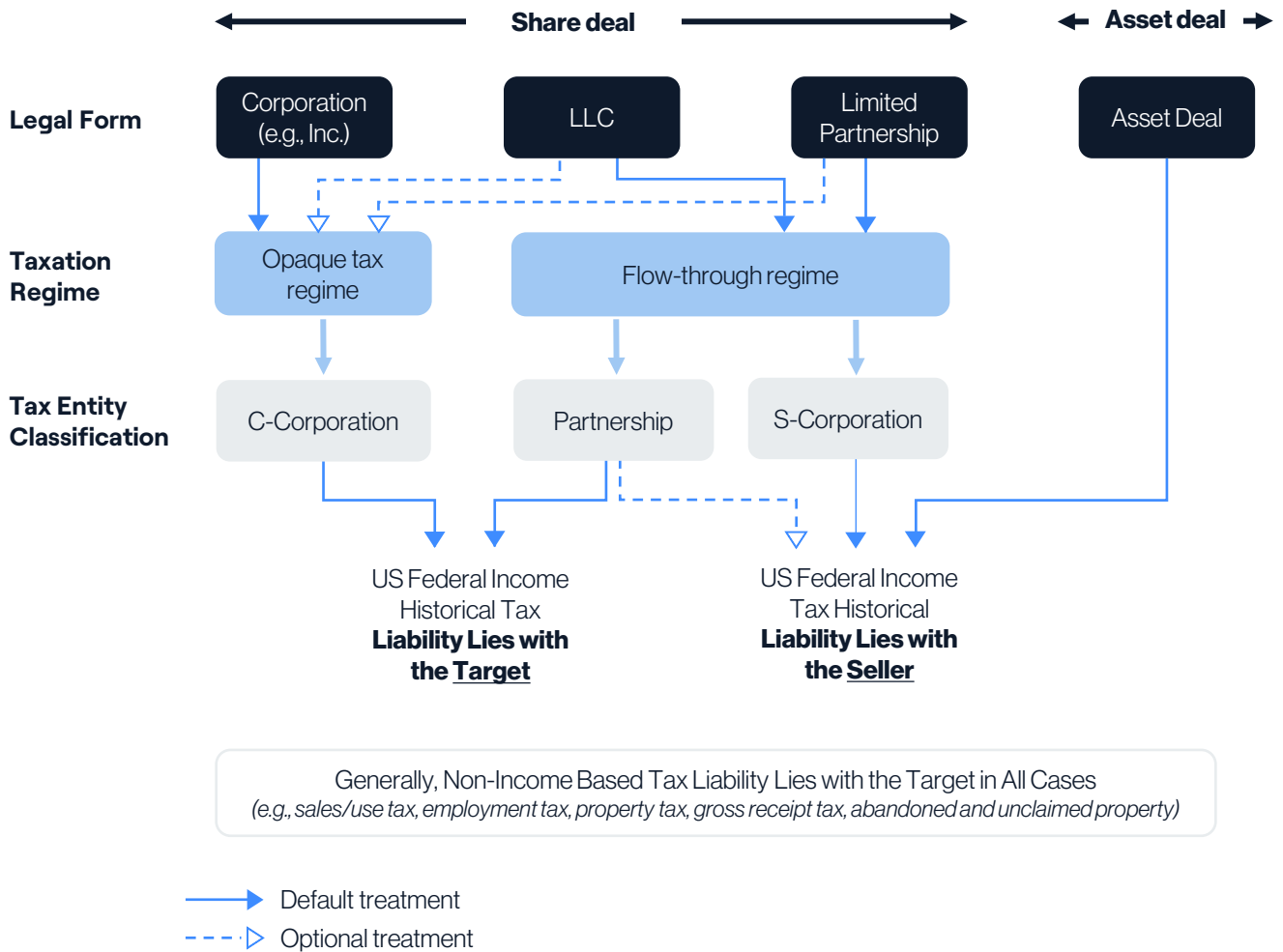
The vast majority of transactions in Europe consist of share deals rather than asset deals, except in specific sectors such as life sciences, real estate, and in distressed situations. Generally, a target company is liable for all taxes related to its activity. Consequently, in case of share deal, a buyer will inherit its past tax liabilities (as they are acquiring the legal entity and not specific assets). In such instances, a thorough tax due diligence of the target is recommended.

By contrast, US entities are subject to different tax regimes which limit the types of taxes that are, or are not, transferred. Thus, upon share deal, the scope of work for the tax due diligence ought to be defined and tailored on a case-by-case basis, while limited past tax liabilities are generally inherited upon asset deal.

The following chart displays a high-level summary of the principles determining where tax liabilities would lie, depending on the target company's US tax regime.

Preparation and negotiations

Figure 1: Impact of deal structure on tax liability



The above chart is not exhaustive and intends only at displaying a simplified presentation of the general framework. A case-by-case analysis shall be performed in each situation.

Availability of Sell-side Due Diligence

Sell-side financial, legal and tax due diligence is very common in European transactions, but less so on US deals. Further, sell-side advisors in Europe would generally provide reliance on their deliverables, while US ones generally would not.

Due diligence

Due diligence processes and key topics differ in many respects between Europe and the US. We present hereinafter the key considerations across the finance, tax, and employment law due diligence streams, and explore the main differences between geographies.

Finance matters

Audit obligations

In Europe, audit is often mandatory for private companies exceeding certain size thresholds. Financial statements audit obligations vary depending on the type of company and the state in the US, with financial statements of private companies rarely being audited. Nevertheless, US companies often have their financial statements reviewed by a certified public accountant, whose conclusions do not constitute a proper audit opinion.

Applicable GAAP

In Europe, financial statements are usually prepared in accordance with IFRS or local GAAP. In the US, US GAAP is most common. Differences in treatment of specific matters, particularly regarding to specific industries, remain between IFRS and US GAAP. Examples include licensing revenue or research & development expenses in the life sciences industry, shipping and handling revenue in the logistics industry, capitalization of advertising costs in the media industry, etc.

Accrual versus Cash accounting

In Europe, accrual accounting is preferred to cash accounting, albeit certain European countries allow cash accounting for small businesses similarly to the US. Under cash accounting, revenues and expenses are

recognized only when cash is received or paid. Under accrual accounting, revenues and expenses are recognised when they are earned or incurred, regardless of when cash changes hands. Given the materiality of the impact that these accounting methods may have on the reported profitability of a target company, due diligence on financial statements prepared under cash accounting would generally entail additional procedures. This is particularly true for target companies not invoicing their customers, or paying their suppliers or employees, at least monthly.

Due Diligence approach

Financial due diligence delivered in Europe tends to be more business-oriented than that prepared by US advisors. European diligence generally goes above and beyond the sole analysis of value statements and gives further insight on top-line and profitability trends specific to the operating model of the business being analysed. Financial due diligence in the US tends to be limited to a quality of earnings analysis and to be more accounting-oriented given the proportion of companies whose financial statements are unaudited and prepared on a cash accounting basis. Ultimately, this can vary from one transaction to another depending on the expectations and needs of the buyer.

Due diligence

EBITDA definition

EBITDA is not defined under IFRS or US GAAP. Interpretation of EBITDA by a US company would generally be more straightforward than that by a European company, with EBITDA being calculated as net income before income-related taxes, financial income and expenses, and depreciation and amortization of long-term assets.

There is often more due diligence work to be performed over the definition of EBITDA and below EBITDA items for transactions on European assets than on US ones.

Sources of information

Main sources of financial information in Europe are often both periodic trial balances and management accounts, with the latter offering more analytical depth than the former.

In the US, statutory trial balances and underlying general ledgers are often the most reliable financial data available, noting there tend to be fewer differences between periodic accounting closings and annual ones in the US than Europe.

When available, statutory audited financial statements and associated disclosures tend to be more detailed when prepared in compliance with US GAAP than under other local GAAP applicable in Europe. The level of detail in the annual reports of listed companies is broadly similar in the US and in Europe.



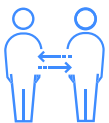
US assets remain highly attractive due to their strong underlying fundamentals. However, thorough due diligence is essential to identify and assess all potential risks and opportunities, ensuring informed investment decisions.

Edouard Decamp, Transaction Services Partner at Eight Advisory, New York

Due diligence

Tax matters

While certain tax issues are similar across jurisdictions, others present significant disparities between the US and Europe. The items below outlines a selection of key tax risks that are frequently flagged as part of tax due diligence on both sides of the Atlantic.



Recharacterisation of a subcontractor into an employee

Description

- Local tax authorities can reclassify certain workers, engaged as independent contractors, as employees if the work performed by such workers closely resembles the work typically performed by employees.

Consequence

- In certain cases, this would result in an additional employment tax liability with an impact on net debt (for the past) and a potential impact on EBITDA (going forward, particularly if the company chooses to convert contractors into employees).



Tax attributes transfer

Description



- Tax attributes cover tax losses, tax credits, capital losses, interest expense carry forwards, etc.
- In the US, an asset acquisition does not allow the transfer of tax attributes to the buyer.
- In the case of a share deal, the transfer of tax attributes is subject to complex rules and limitations on utilization resulting from a change of control.



- In Europe, as in the US, an asset acquisition does not allow the transfer of tax attributes to the buyer.
- However, unlike in the US, rules may significantly differ from one jurisdiction to another. While a change of control generally has limited impact on tax attributes in France, this is not the case in Germany or the UK.

Consequence



- More due diligence work (and appropriate tax modeling) would likely be required in the context of a share deal, particularly if the seller requests that tax attributes be valued.



- The extent of the due diligence work would likely depend on the jurisdictions at hand.

Due diligence



Under collection of sales tax (assimilable to VAT)

Description



- A sales tax liability may arise in US states where a company delivers more than a certain threshold of sales or number of transactions (so-called "economic nexus criteria").
- This threshold is generally set at \$100,000 per state per year, although it varies from one state to another.
- This topic is not often properly monitored, especially at small companies, which may create a sales tax liability in one (or more) state(s).



- VAT is due from the first euro of sale, except in certain VAT-exempt sectors such as healthcare, education, banking and insurance.
- VAT collection is usually correctly managed in Europe, except in the context of complex transactions, real estate-related services, tax exempt services and distance selling.

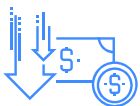
Consequence



- In certain cases, this would result in an additional sales tax liability impacting net debt (for the past) and a potential impact on EBITDA (going forward if the company continues selling in the same states and/or expands to other states without collecting sales tax).



- In case of VAT collection failure, tax consequences are similar to those in the US.



Limitation rules over interest deductions

Description

- There are several layers of rules limiting the tax deductibility of interest, which are rather common to both geographies, even though specific rules apply depending on the jurisdictions.
- The most frequent rules include (i) potential recharacterisation of debt into equity (more frequent in the US than in Europe) and (ii) 30% tax EBITDA / EBIT limitation (i.e., net interest deductions by taxpayers are limited to 30% of tax EBITDA / EBIT).
- These rules are not always correctly applied.

Consequence

- In certain cases, this would result in an additional corporate income tax (CIT) liability with a potential impact on net debt (for the past).

Due diligence



International tax risks and transfer pricing

Description



- US entities are generally taxed on their worldwide income, which is enacted through various complex income inclusion and anti-abuse rules.
- When a US target has activities abroad, significant tax issues may arise.



- European entities are generally taxed on their jurisdiction's income.
- European countries have developed a wide range of instruments to allow tax authorities to target tax evasion and treaty shopping. Such rules vary from one jurisdiction to another but are often relatively similar when derived from European Union (EU) directives.
- Tax authorities can use general anti-abuse rules, allowing them to disregard a transaction/entity when it is mainly performed/used for tax purposes considering relevant facts.

Consequence



- In this context, tax due diligence procedures are likely to be more complex.



- Over recent years, tax authorities particularly focused on withholding taxes on non-domestic payments using the notion of “beneficial ownership”.

Due diligence



Owner's expenses

Description



- Expenses incurred in the sole/exclusive interest of a shareholder or an employee, for a purpose outside the course of the company's business, are not generally tax deductible.



Consequence



- Similar approach applied in the US and Europe with an upward EBITDA adjustment to cancel such expenses (generally flagged in the Finance Due Diligence).



Employment law matters

Due diligence in European deals typically gives a closer look at employment law, where non-compliance, especially with respect to working time, can lead to significant liabilities. In the US, one of the major due diligence matters relates to pensions (e.g., 401(k) contribution plans), a topic often not covered in European employment law audits.

In many European jurisdictions, including Germany, the Netherlands and France, employee representative committees or works councils have compulsory information and/or consultation rights in the context of M&A deals, which needs to be factored in the deal timetable. In France, no binding agreement may be signed before completion of the Social and Economic Committee (CSE) information/consultation. Such consultation shall therefore be completed prior to signing the SPA (as opposed to condition precedent).

Deal signing & closing

Differences between M&A in Europe and the US exist all the way up to the signing and closing of a deal, in particular as it pertains to the Sale and Purchase Agreement and the tax structuring of the transaction.

Key sale and purchase agreement considerations

Price mechanics

Locked Box is often preferred on transactions in Europe, whereby the price is fixed based on the defined locked box date, with underlying price adjustments agreed prior to signing based on historical balance sheets. As a result, the risks and rewards related to trading between the locked box date and the closing are with the buyer (subject to leakage and other protection).

Completion accounts are more common in the US, with an adjustment on the final purchase price based on the target company's financial performance between signing and closing in accordance with the definitions and provisions included in the Sale and Purchase Agreement. As a result, the risks and rewards related to trading until closing remain with the seller.

Deferred price considerations

Earn-outs are a common feature in deals in both the US and Europe. Their use is mostly influenced by factors such as the deal size and the stage of development or nature of the target company (e.g., mature vs. high-growth).

Deals may be more likely to include earn-outs when there are uncertainties about the target company's performance or when the buyer has limited access to debt financing. Deals in Europe tend to have longer earn-out periods compared to US deals.

Warranties

Both in the US and in Europe, (i) rather extensive warranties are usually sought by a purchaser, tailored to

the target company or business being acquired and (ii) repetition of warranties at completion is common, typically (in the case of non-fundamental representations) subject to a materiality qualifier. Representation and warranty insurance is very common in the US, but not so much in Europe (apart from the UK) although purchase has been increasing. "Pro-sandbagging" clauses, allowing the buyer to pursue indemnification claims against the seller if the buyer knew about a breach of representation or warranty before the deal closed, are more common in Sale and Purchase agreements on US deals. In several European jurisdictions, it is not uncommon to include specific "anti-sandbagging" provisions in agreements, particularly where warranty and indemnity type insurance is being used, since the buyer is required to make a no-claim declaration in favour of the insurer.

Disclosure approach

In US deals, disclosures against warranties are typically specific and tied to detailed disclosure schedules that are attached to the agreement. This contrasts with the European approach, where general disclosures based on the whole data room are more common.

Recourse

In both Europe and the US, sellers will often have to accept an escrow, the granting of a parent guarantee or holdback as a source of recovery for buyers each time the sellers' creditworthiness can be challenged.

Deal signing & closing

Termination

In Europe, signing a deal tends to be more binding than in the US, with few options to opt out. US agreements often offer more exit options such as termination or material adverse change clauses.

Foreign investment regulators

European interest deals involving investors from outside the EU go through the review procedure of the European Commission's, in addition to the review of the concerned Member State's authorities, while deals in the US involving foreign buyers are examined by the Committee on Foreign Investment in the United States (CFIUS).

In Europe, foreign direct investment (FDI) refers to the acquisition of equity assets representing at least 10% of the share capital of a foreign company.

When considering an investment, foreign investment regulations must be addressed, as follows:



Competent authority



- Committee on Foreign Investment in the United States (CFIUS)



- Review procedure of the European Commission's and Member States' authorities.



Power



- The CFIUS decision is binding: it can block transactions that fall within its jurisdiction or impose measures to mitigate any threat to national security.



- The European Commission may issue advisory opinions, but these are not binding on Member States, the final decision on whether to block or allow a foreign direct investment in the EU remains with the Member States.
- Local authorities can block transactions.

Deal signing & closing



Threshold



- Any transaction that could result in the takeover of a US company by a foreign entity. The definition of “control” is broad and refers to the direct or indirect power (whether exercised or not) to intervene or make decisions on important matters concerning a company. Minority investments may be affected.



- Differ from country to country (i.e., in a very general way: 10% in France, 25% in the UK and Luxembourg, no threshold in Switzerland, etc.).



Penalties



- Potential civil penalties for non-compliance or for violating a significant provision of a mitigation measure.



- No legal sanctions are foreseen at the EU level. Different sanctions apply at the Member State level (e.g., in France, the transaction is deemed null and void; the ministry may also impose fines of up to 5M€ for legal entities).



Protected sectors



- Transaction that could have an effect on the national security of the United States. As such, the CFIUS guidance provides for an illustrative list of sectors to consider in assessing whether the transaction poses national security risks: defense, energy, transportation, financial services, technology transfers and radiocommunications (not limitative). Sub-federal restrictions on investment also apply, which require formal filing and government consent prior to the acquisition of a target company or business whose activities fall within a defined set of industries.



- In Europe, there are differences in the sectoral scope of foreign direct investment screening mechanisms: only a few Member States can screen any sector, while others rely on lists of sensitive sectors or specific assets.
In France, foreign investments in sensitive sectors including defense, energy, natural resources, telecoms, health, R&D in critical technologies (e.g., cybersecurity and biotechnologies), may require the prior approval of the Minister of Economy and Finance.

Deal signing & closing

Key tax structuring issues

Acquisition vehicle

For European acquisitions, investors usually use one of their existing companies or a local tax-opaque acquisition vehicle.

For US acquisitions, investors have a larger number of options for the business structure (e.g., LLC, Partnership, Corporation) of the investment vehicle. The business structure selected will ultimately depend on investors' commercial goals and constraints. Eligibility of the acquisition vehicle to double tax treaties should also be considered when deciding on the business structure. For instance, US disregarded entities (i.e., US pass-through entities with one shareholder) may not be considered as a taxable person for the application of certain tax treaties with European countries.

Acquisition financing

The mix of debt versus equity when financing an acquisition is a key topic in both the US and Europe. Overall, deals frequently rely on external financing such as bank or syndicated loans, albeit this varies with deal size.

In the US, a specific analysis is required to confirm the appropriate debt versus equity mix, but also to limit the risk of recharacterization of debt financing into equity (frequent topic in the US). In Europe, tax authorities tend to focus more on the arm's length nature of interest rates, but thin-capitalization rules are also very frequent. Numerous other limitations exist regarding financial interest tax deductibility in both the US and Europe. A general limitation up to 30% of the tax EBITDA generally applies. In many jurisdictions, interest expenses associated to the acquisition debt may be deducted against the taxable result of the target company through tax consolidation or merger.

Transfer taxes

In both the US and Europe, M&A transactions result in limited or no transfer taxes in equity transactions, except when real estate assets and long-term leases are in the transaction perimeter or if the deal is an asset acquisition. In that case, rules differ significantly from one jurisdiction to the other.

Cash circulation

Intra-European Union and intra-US cash circulation (e.g., dividends, interest, royalties) is generally exempt from withholding tax in the paying/distributing jurisdiction, while transatlantic cash circulation may be subject to withholding tax in the country of the payer.

Purchase price allocation

When acquiring assets, or deemed assets, in the US, the parties to the transaction are required to allocate the purchase price among the various underlying assets.

In Europe, a purchase price allocation is not necessarily needed. However, such allocation may be performed in order to support a transfer pricing policy going forward.

Deal signing & closing

US Goodwill tax amortisation (step-up in basis)

Asset and deemed asset deals are frequent in the US. The acquisition results in a step-up of the tax basis of the transferred assets to fair market value. Goodwill may be depreciated for tax purposes over a 15-year period. In Europe, asset deals are unusual and goodwill generally not tax depreciable.

Management package

The practice of setting up management packages originates from the US. Such practice is unequally spread over the different European countries.

In the US, management rollover can generally be done on a tax-deferred basis when reinvesting in a US target and if properly designed. However, tax-deferred rollover for non-US management may not be possible depending on the jurisdiction. If there are significant non-US members of management, additional consideration should be given to taxability of management incentives.

In Europe, management packages have a long-standing practice in France and the UK. For instance, in France, capital gains from the disposal of shares under a management package are generally subject to a lower tax rate than salary income. In recent years, tax authorities have (sometimes successfully) recharacterized such capital gain into salary, on the ground that the management package had been granted to managers by virtue of their status as employees. In case of successful recharacterization, a higher social security contributions cost may be due for the company bearing the management package. In most other European jurisdictions, the disposal of shares under a management package are generally taxed as salary income.



Tax structuring shall be anticipated as early as possible in the transactional process (especially in US deals), to factor potential value drivers in the price (such as tax step-up) and, at the same time, to identify potential roadblocks.

Guillaume Rembry, Managing Partner of Eight Advisory Avocats

How we can support you

Vendor & Buy-Side Due Diligences

We perform Vendor Due Diligence, Buy-Side Due Diligence, and Independent Business Reviews, covering financial, tax, legal, and social aspects. Our teams are involved through every steps of deal processes, and are experts on complex and cross-borders transactions.

M&A Consulting and Legal Assistance

We offer integrated strategic and legal advice for M&A transactions from initial negotiations to closing. We assist with the drafting and negotiations of LOIs and term sheets, contractual documentation (SPAs, representations and warranties, SHAs, etc.), and corporate documentation. We also provide support with social obligations, such as work council consultation and the Hamon law.

Valuation, Modelling and Transfer Pricing

We cover business and asset valuation, financial modelling, and transfer pricing. Our teams are involved in M&A transactions, capital restructuring and regulatory obligations.

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Tax Structuring and Advisory

Our tax teams assist in designing and implementing transactions, reviewing financial models, managing tax issues related to transactions, diagnosing and assessing of tax management, as well as with other tax matters (e.g., tax audits and litigations, transfer pricing, complex reorganizations).

Capital Market Services

We support companies with capital and debt raising projects, IPOs, and complex financial structuring (public M&A, carve-out, GAAP conversion, etc.). Our team assists in structuring and drafting deal documents and corporate agreements, financial statements, as well as help with regulators-imposed rules and filing requirements and related financial communication.

Contact our experts and see how we can help you!

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