

Insights

INCENTIVIZING KEY EMPLOYEES IN A COMPANY SALE

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Summary

When a company is preparing for a sale, transaction-based incentives can be an effective way to recognize and retain key employees. In practice, these incentives generally fall into two categories –equity and non-equity (cash)—and the right approach depends on several factors, including timing, the employee population you want to reward, how awards will be valued and paid, and whether Section 280G may be implicated.

Start with the award type (equity vs. non-equity)

- **Equity vs. non-equity.** Transaction-related incentives are typically structured as either equity or non-equity (cash) awards.
- **Timing matters.** Equity awards are often most effective when granted well in advance of a potential transaction. This allows time to establish an equity plan and begin. If a buyer is already engaged, it is often simpler and more practical to use a non-equity cash award for service providers.

Decide who should receive transaction-based awards

The next step is determining who you want to reward. This may include all employees, employees with a minimum tenure, select executives, or another defined group. There is no one-size-fits-all approach, and different employee groups may receive different forms of transaction-based awards.

It is also important to factor in existing incentives.. For example, if an individual will already receive a substantial payout due to pre-existing equity awards, consider whether an additional transaction-based payment is necessary or appropriate.

Finally, think through leaver scenarios. If an employee leaves before closing, should they still be entitled to a transaction bonus or payment? Addressing these questions upfront can help avoid disputes and complexity later in the process.

Determine award value (and what it should be tied to)

Value is often the key issue. For cash-based incentives, amounts are commonly tied to the purchase price and/or the perceived value of the individual's contribution to successfully completing the transaction.

For senior executives, some payments may be structured to align with earn-outs (if applicable) or escrow releases.

Plan payment timing (closing, earn-outs, and escrow)

Payment timing will typically depend on the type of award:

- Equity-based awards are often paid in the first payroll following closing, but generally may be paid at any time before March 15 of the year following the year in which the transaction closes.
- Simple cash-based awards are commonly paid on the same timeline.

In many transactions, buyers and sellers prefer to make these payments shortly after closing so they can be administered efficiently and the parties can move forward.

For awards tied to earn-outs or escrow releases, payments are typically made within a specific period—typically 30 to 60 days—after the earn-out is calculated or the escrow is released.

Check Section 280G exposure

When determining who should receive awards and in what amounts, it is critical to consider whether Section 280G of the Internal Revenue Code applies to the transaction. Certain transaction-based payments could trigger Section 280G.

Practical takeaway

When structuring transaction-based incentives, companies should:

- Choose between equity and cash (non-equity) awards, largely based on how far in advance of a transaction awards will be granted.
- Define the eligible population, including how existing incentives and termination scenarios will be handled.
- Set award value, commonly tied to purchase price and/or the perceived value of an individual's contribution and sometimes tied to earn-outs or escrow releases.

- Confirm payment timing, including closing-related timing and any earn-out/escrow timing.
- Evaluate Section 280G implications when determining recipients and award amounts.

Related Capabilities

- Employee Benefits & Executive Compensation

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