

Incentivizing Employees with Phantom Equity

Sarah Sawyer: Welcome to this week's OK at Work with myself, Sarah Sawyer, my colleague Russell Berger both attorneys at Offit Kurman. And today we are talking about certain types of incentive compensation. You know, we're getting towards the end of the year and often folks are wrapping up their year and looking at bonuses and looking at how people performed and figuring out various things as is compensation looking ahead to next year.

Trying to figure out how they wanna incentivize employees based on their business goals and what they're looking forward to in 2026. And one way that companies often do that is through something called phantom equity. And there's other similar concepts as well, but what is, other than sounding a little bit mysterious what is phantom equity Russell?

Russell Berger: Yeah, look it, it's not real equity. So that's the starting point. That's why it's [00:01:00] called phantom equity. And what it really is designed to do is to function. I mean it's really, if you think about it somewhere between actual equity, but obviously without the actual equity and kind of normal bonus plans, it's sits somewhere in between and it provides an option to businesses to compensate, usually executive level folks in a manner as if they were a member of equity, even though they're not.

And there's a lot of different variations to it. There's, as creative as you can be, you can plug that in. One of the common uses is to award phantom equity units to an executive. Maybe they get awarded, they have to vest over time. Maybe they're just awarded upfront. But then, all they really do is function as a way to bonus the individual in the event of a triggering event. For example, that might be something like the sale of the business. It could be, you don't own any actual equity which is good, less entanglements. Lot less complicated.

But if the business sells in this [00:02:00] timeframe, then you know, you get a bonus as if you owned 5% of the company. And there might be escalators, deescalation, different ways of looking at it. But yeah, you get 5% of the net proceeds of a sale and that's a good way to incentivize an executive to hang around and really drive towards a sale.

And sometimes they can be used for profit sharing in a similar way as well.

Sarah Sawyer: It's a good way to try to align both the company's goals and the individual's goals together. So part of the reason that people might have actual equity in a company, not phantom equity, is to align those goals and say, all right, you share in our successes and we wanna motivate people to share in when the company does well, you do well. And it might motivate people to care a little bit more about what the business's perspective is. But with actual equity it can be much more sticky. It's a much more often a more solid relationship.

They might have other types of control as part of that, they might have a say in business decisions. So it's a way of stopping short of having really [00:03:00] that cemented of a relationship or having all of those other pieces while still helping motivate people in a streamlined way.

Russell Berger: Yeah if you don't wanna deal with the entanglements of ownership, subject to the same operating agreement, what have you, and you don't wanna deal with the tax consequences, and on down the list of reasons why you might not want to give someone equity

or sell someone equity but you do want to foster that ownership thinking among your executive team.

And this is a construct that gives you more flexibility as the business owner, but creates the right incentive structure. And again, whether that's to make profit, to prepare for a sale, or, anything in between or combination thereof. It's a good tool to get alignment on ownership thinking without actually dealing with the burdens of shared ownership.

Sarah Sawyer: Well, thanks, Russell, and we'll see you next time.

Russell Berger: Thanks, Sarah.

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