



Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

Episode 56

By [Megan Monson](#), [Amy C. Schwind](#)

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Megan Monson: Welcome to the Lowenstein Sandler Podcast Series. Before we begin, please take a moment to subscribe to our podcast series at Lowenstein.com/podcasts, or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now let's take a listen.

Welcome to the latest episode of *Just Compensation*. I'm one of your hosts, Megan Monson, a partner in Lowenstein Sandler's Executive Compensation, Employment and Benefits Practice Group. I'm joined today by one of my colleagues, Amy Schwind, who I'll turn it over to introduce herself.

Amy Schwind: Thanks, Megan. Hi, my name is Amy Schwind and I'm senior counsel in the same group. I'm happy to be here today.

Megan Monson: Today's discussion will focus on key considerations for employee commission plans. Often, particularly sales employees, are compensated in part by commissions. Through commission compensation, employers aim to provide incentives for employees to make sales and drive predictable revenue but also used as a tool to attract and retain talent. In this podcast, we will explore best practices and legal considerations for commission plans. As always, if you have questions related to particular circumstances in your workforce or regarding specific legal issues, we encourage you to consult with your legal counsel.

So, to jump right in, Amy, what are some big picture considerations employers should be aware of when it comes to commission plans?

Amy Schwind: First and foremost, some states, like New York and California for example, require a written commission plan for commissioned salespeople. And even if one is not required by applicable law, it is a good idea to have one to avoid disputes. Also, keep in mind that commission plans are routinely looked for during the corporate diligence process. It's important to avoid ambiguity, as it is typically construed against the employer. Another rule of thumb is that employers can't retroactively change a plan.

Megan Monson: So if a company does in fact memorialize their commission plan in writing, what are the recommended core components of such plan?

Amy Schwind: There are really four key core components. Eligibility, who and what is eligible. Earning, when is the commission earned. Calculation of the commission. And finally, when will the commission be paid.

Megan Monson: I think that makes a lot of sense, Amy, especially in going back to your earlier point that part of the goal is to avoid there being any sort of disputes. So I think touching on these key areas, it would be very clear of the terms of such a commission arrangement.

Can you provide a little bit more insight into eligibility for commissions?

Amy Schwind: First, is there a plan period? Are we looking at a calendar year or a fiscal year, or something else? For what type of sales is the employee eligible to earn commission? So you'll want to define qualifying sales, products, or services and territories of any channels and deal types and include any exclusions. For example, if you want to exclude house accounts or renewals or internal transfers.

And then what does the employee have to do to earn the commission? So first, what roles are eligible to earn commission. Does the employee have to be solely responsible or the sole originator of the contract or deal? Do they have to have material involvement? Is there any splitting or sharing of credit on sales or accounts? And are there any other prerequisites, like having internal approvals or submitting documentation in CRM, adhering to all sales processes and requirements, standards, and policies. That would be pretty typical.

Megan Monson: Amy, you mentioned another one of the core components is related to when commission is earned. So, what's the significance of when commission is earned?

Amy Schwind: Once a commission is earned, it's subject to wage and hour requirements. This is a critical component as it is linked to other aspects, such as when commission must be paid under applicable law since it is then a wage, and what happens upon termination of employment.

From my perspective, this is the single-most significant thing that needs to be in a commission plan, and employers do often leave this out. Is it based upon customer contract execution, payment received from the customer, the employer making commission payment to the employee? Is it not earned until paid or something else? We need to say when the commission is earned. And absence or vagueness of this provision can lead to unintended consequences, like having to pay commissions before a sale is final or payment is received.

Megan Monson: Yeah. So, I think from what you've just said, Amy, this I think really seems to emphasize the importance of having counsel involved in drafting certain commission arrangements to ensure that they do have all of the right core features in that arrangement.

Amy Schwind: Absolutely, it can be really complex. Hopefully this podcast helps to distill it down. But yes, absolutely there are things from a legal perspective that you do just really want to make sure that you have included in your plan.

Megan Monson: So, what are some things to think about when it comes to specifying commission calculations?

Amy Schwind: It's important to ensure the calculation is specific and transparent. What metric applies? So, is it contract value or the billed amount or the collected revenue or the gross margin or something else? You'll want to define key terms based upon which you are calculating commission. For example, common ones like net revenue or net new ARR or gross revenue or net invoice amount. You can't just assume that everybody knows what we mean by this. You want it defined within your plan.

Also, think about is there anything to net out? And this needs to be factored into the equation to avoid improper deductions from earned wages. So, for example, things like taxes or refunds or credits, fees, shipping discounts, material costs. Are we netting anything out from the equation? Also, are you paying commission on renewals, contraction, churn, existing customer expansion? If no, be clear. And if so, is it at the same or a lower rate? Must there be active effort or is auto-renewal of a contract sufficient?

Employers that want to incorporate a chargeback or a claw back or other repayment true up or adjustment in the event a customer returns a product or cancels a service, or otherwise if there is an overpayment, need to be mindful of when commission is deemed earned to avoid running afoul of wage and hour law by taking deductions from earned wages. This can be addressed in various ways to avoid issues, and again, is a good reason to get legal counsel involved. Also, specify the rate applicable to the calculation. So, is it a flat rate? Are we doing a tiered rate, some sort of accelerator, cap, or quota?

Megan Monson: What should be specified in terms of commission payment?

Amy Schwind: Once earned, commission must be paid. So, when is commission paid? It should be specified. Is it within a specified time after a month or a quarter closed? And state law may dictate payment timing.

Megan Monson: What if an employer wants to offer an advance or draw against commissions? Because I know I've seen that come up from time to time.

Amy Schwind: Yeah. Under this type of arrangement, the employee generally receives an advance or credit against future earned commissions. It's important to specify whether it is recoverable or non-recoverable, and the method and schedule of reconciliation of the amount advanced and the actual commission earned. This, again, involves specific drafting to ensure compliance with wage and hour law.

Megan Monson: Should a commission plan specifically address what happens upon a termination of employment?

Amy Schwind: Absolutely. This is another very key component that I often see is missed. A commission plan should address what happens when employment terminates. Specifically, is the employee still eligible to earn commissions? Does the employee have to be there on the date of payment to receive commissions? Is commission not earned until paid? And the permissibility of these types of provisions is impacted by applicable state law.

Megan Monson: And I'll also just add in that from a tax code perspective, in particular Section 49A of the Internal Revenue Code that governs deferred compensation, any payments paid with respect to compensation related to employment need to either comply with or be exempt from 409A. And therefore, if there are payments still being made after an employee no longer works there, careful care needs to be taken to make sure that the payment schedule aligns with what's a permissible payment schedule under 409A. Otherwise, they run the risk of being subject to certain adverse tax consequences for failing to follow 409A, which we've covered in prior episodes of this podcast.

In closing, what are some other good rules of thumb when it comes to commission plans?

Amy Schwind: It's important to reserve the company's right to modify or terminate the commission plan going forward and also to preserve the company's sole discretion to interpret the plan and resolve disputes. Companies should state that the commission plan is not a contract of employment for a term and it does not alter at will employment. Also, ensure the employee receives a fully executed copy of the plan, and it's always a good rule of thumb to review a commission plan annually or at least periodically.

Megan Monson: Well, thank you so much, Amy. This was a very helpful discussion highlighting legal considerations regarding commission plans and really emphasizes the need of proper papering and structuring for compliance with various wage and hour laws, as well as trying to avoid any ambiguities or disputes with employees.

We encourage you to consult with counsel on specific questions regarding commission plans or requirements. Thanks for joining us today. We look forward to having you back for our next episode of *Just Compensation*.

Megan Monson: Thank you for listening to today's episode. Please subscribe to our podcast series at [Lowenstein.com/podcasts](https://www.Lowenstein.com/podcasts), or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud or YouTube. Lowenstein Sandler Podcast Series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. Content reflects the personal views and opinions of the participants. No attorney-client relationship is being created by this podcast and all rights are reserved.