

*HPVA is fortunate to have Leon and Terrance Resnick speak to our Cincinnati Fall Conference registrants on “Conserving Your Family’s Wealth” on Tuesday, September 15 from 3:15 PM to 4:45 PM. There will be time for private appointments with Leon or Terry Resnick Tuesday afternoon and Wednesday morning. You can email them at [ResnickAssoc@aol.com](mailto:ResnickAssoc@aol.com) to set up a private appointment with them.*

The Ray Zerbak family has called Arkansas home for 100 years and their family business, Zerbak Flooring, Inc. has called Arkansas home for over 40 years.

Well entrenched in the beautiful landscape of Arkansas, this family has no intention of either they or their business leaving the Natural State. Starting with two employees in 1966, Zerbak Flooring now has an employee base of 80 and annual revenues that exceed \$50 million. The hard work has paid off and the Zerbaks, as a result of their successful company, enjoy a very comfortable lifestyle.

Ray, now 65, is still intricately involved with the company and owns 100% of Zerbak Flooring. His wife, Rachel, phased out of the business in 1968 when they had the first of their 3 children. Two sons, Nathan and Adam, are very involved in the day to day operations and have worked their way up to management level with the hopes of one day taking over the family business. Their sister Lauren, although very close to her brothers, never showed much interest in the family flooring business and while she still lives in the same Arkansas town as her family, is involved in a career unrelated to the flooring industry.

The Zerbaks are a classic example of a family business that took a chance, worked incredibly hard and made their flooring company successful. It is of the utmost importance to the Zerbaks that Zerbak Flooring continue on for Nathan and Adam and, if possible, future generations of Zerbaks.

Unfortunately, when it comes to a family flooring business, intentions aren’t what makes these goals and dreams happen – proactive estate and succession planning are the keys to driving a family business into and beyond the next generation. Actions speak much louder than intentions, and insufficient or improper planning combined with hefty federal estate taxes speak louder than anything.

With a 2 out of 3 failure rate of first generation family businesses making it to a second generation, the Zerbaks will find that successfully transferring their business to Nathan and Adam may be more challenging than the current economy.

Zerbak Flooring is doing well. What challenges will this family face when it comes to transitioning their company?

1. Do Ray and Rachel transfer the business 1/3 each to each child (although only two of three are active)
2. In addition to their company, Ray’s and Rachel’s estate is made up of additional non-business assets. They are presently faced with a corresponding federal estate that will

be millions of dollars (due and payable 9 months after the second death of Ray and Rachel).

3. There are three key employees that are absolutely vital to the day to day success of Zerbak Flooring – what assurances do Nathan and Adam have that these key employees will stay once Ray exits the business?

These are just a few of the very common, yet often overlooked challenges for a successful flooring company. If these areas are not addressed through quality estate and succession planning, then the Zerbak family will be almost assured of losing the company. Conversely, if proper planning is implemented and reviewed annually, they have a very good chance of seeing their business continue successfully for many, many more years.

Issue number 1: From our experiences, unless it is a very unique situation, we generally recommend that only children that are actively working in the company receive business interests in a family held flooring concern. Typically, the flooring company and related assets comprise 70% or more of a business owner's estate. If there is one child working in the company that ultimately gets a 70% distribution of the estate assets, without proper planning, that means if there are three other children they will receive 10% each. Properly structured life insurance is the key asset in equalizing the inheritance for children of flooring company owners. There is no other planning technique that allows the immediate creation of wealth. Caveat: The correct acquisition and implementation of life insurance for estate and business planning is often complex and sophisticated. As with legal and accounting/valuation work, it is critical that this part of the planning is handled by experienced specialists. There are countless stories of business owners having life insurance only to see premiums unexpectedly skyrocket, implosion of policies, etc.

Issue number 2: Insufficient liquidity, when it is needed most, has been a constant in destroying family businesses. As stated earlier, the federal estate tax, with current rates at 45%, is due within 9 months after the date of death of the second spouse. In the Zerbak case, Ray and Rachel have a significant estate, but it is mostly illiquid. How will the executor raise millions of dollars within 9 months? Their "solution" as it is for other closely held family businesses is to liquidate hard assets (i.e. Zerbak Flooring, land holdings, etc.). Liquidating is the last thing Ray Zerbak would ever *want* to do. He and his family have worked too hard to build the business not to see Ray's and Rachel's sons continue its success. If the Zerbaks don't liquidate, however, how else is the family coming up with the large amount of cash to pay the IRS? The company should qualify for a Section 6166 program (IRS 14 year installment plan), as Ray's closely held stock makes up more than the required minimum of 35% of the total of his and Rachel's estate. The problem with Section 6166? Other than Zerbak Flooring being a business partner with the IRS for 14 years, even with nominal interest rates the first 4 years of the 14 year plan, when all is said and done, the Zerbak estate may pay 2 to 3 times (through principal and interest) of what the original tax bill was.

Although, there are many tax planning strategies available, when a tax bill becomes due the options to pay the bill are few. If an estate is liquid, there is the option of paying cash from the estate. This will take care of the obligation, but is obviously expensive as a family is paying 100 cents on the dollar AND losing the cash and future appreciation of the cash forever. Secondly, if an estate qualifies, the executor can borrow money. This route is even more expensive than self

funding the tax, as the loan amount and interest must be paid. Thirdly, is the option the Zerbaks don't want to entertain – selling Zerbak Flooring to raise capital to pay their tax bill. Finally, life insurance, if acquired and structured properly, can save the Zerbaks millions of dollars compared to the other methods of payments. By positively leveraging premium dollars into a tax free death benefit, the Zerbaks will: take care of their tax bill, save millions of dollars in the process AND succeed in their goal of keeping Zerbak Flooring in the family.

Issue number 3: If the tax bill is paid and Nathan and Adam now equally own Zerbak Flooring, what happens if another company lures away the 3 key people? Overnight, Zerbak Flooring can become a significantly different company – and not for the better. In this instance, “golden handcuff” programs should be implemented to retain these 3 valuable employees. The “golden handcuff” would be an asset to the company and the 3 employees would have a very attractive retirement program should they stay with the company until retirement. Many business owners are under the impression that the only way to retain key executives is by giving away ownership interests in the company. This is not the case as properly designed deferred compensation programs; many times will provide the same end result of retaining the employees as would the transfer of ownership.

There are, of course, many other issues involved in perpetuating a successful flooring company. The issues referenced in the article are critical and business owners should not minimize the importance of addressing them. It can literally mean the difference between your company surviving or not.

*Resnick Associates will be appearing at the HPVA Fall Meeting in Cincinnati. Terrance and Leon Resnick can be reached in their central Pennsylvania office at (717) 652-2929 or their Kansas City office at (913) 681-5454. They may also be reached by email at ResnickAssoc@aol.com.*