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How can a small business owner pass an interest to heirs without triggering a significant estate tax bill? Despite generous tax breaks, there still may be obstacles to overcome, especially with the estate tax exemption scheduled to be cut in half in a few years.

Fortunately, business owners may rely on an ace in the hole: the special use valuation method. This election by an executor can save a family thousands in estate tax.

But the tax payoff isn't automatic. The election is allowed only for real estate

Key point: The fair market value (FMV) of real estate owned by a decedent at death is included in their taxable estate. Generally, FMV is determined by the property's "highest and best use." In other words, if the property is vacant land that would be worth a small fortune to real estate developers as a mall, a condo complex or golf course, the higher value is treated as its FMV for estate tax purposes.

This often works against business owners who own prime real estate. Their heirs may be stuck with an inflated estate tax bill

Special election: If certain requirements are met, business real estate or a farm can be valued based on its current actual use upon the owner's death—not its highest and best use. For these purposes, business real estate includes buildings and other structures regularly occupied or owned by the owner and used to operate a closely-held business or farm.

To qualify for this estate tax break, the net value of the property must be at least 50% of the decedent's gross estate and 25% of the decedent's adjusted gross estate (the gross estate reduced by certain deductible debts, expenses, claims and losses). Furthermore, the decedent must have transferred the business to a qualified heir or heirs like the owner's children or grandchildren.

In addition, the business must have been owned and operated by the decedent or a close family relative for five out of the eight years prior to death.

Note: The reduction in the estate tax value under this election can't exceed a threshold of $1,23 million in 2022 (up from $1.19 million in 2021).

Finally, there's one other catch. If the heirs sell to outsiders or otherwise dispose of the property within ten years of death, or they begin using the property for other purpose, the estate tax savings must be recaptured. It’s important that all parties are

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