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2006: try to stay under $1 million in gross receipts or see their state franchise tax bill go overnight from zero to thousands of dollars.

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Thousands of small-business owners in Texas have faced a year-end dilemma since 2006: try to stay under $1 million in gross receipts or see their state franchise tax bill go overnight from zero to thousands of dollars.

Companies surpassing $1 million in gross receipts were taxed on all of their gross receipts, not just the amount above $1 million.

In tax parlance, it was known as "the cliff."

"The next dollar you earn could take you to a $7,000 tax," said Dale Craymer, president of the Texas Taxpayers and Research Association. "It created a disincentive for businesses to keep operating at the end of the year. You were better off closing your doors."

As of Wednesday, the cliff became a slope. The Legislature last year created a new deduction allowing businesses to deduct $1 million from their gross receipts for the franchise tax. The franchise tax, more commonly known as the margins tax, is the state's primary tax on businesses.

The state's smallest businesses, those with less than $1 million in gross receipts, remain exempt from the tax. But eliminating the cliff gives the tax a more phased-in impact on companies making between $1 million and $3.3 million in gross receipts.

An estimated 26,000 companies — or almost 1 in 4 that owed the tax in 2012 — will see a tax savings in 2014, according to the state comptroller's office.

Central Machine Works in East Austin is one of those companies that will shave

“We usually don't have to try too hard to stay under it,” joked Bennett. “We may have gone over it a couple of times.”

Patricia Whiteside, an Austin certified public accountant who represents the company, said she has had to advise several clients at the end of the year, “Don't send out any more bills.”

Whiteside praised the change in the law because it also helps companies, including Central Machine Works, that don't benefit from the tax's major deductions — the greater of the cost of goods sold or employee compensation.

Central Machine Works — primarily a service company — never had enough costs of goods sold to take advantage of that deduction. And with only nine workers, it never had enough employee compensation to offset its tax obligation.

The new $1 million deduction doesn't help larger companies making more than $3.3 million in gross receipts.

At that level, Whiteside said, it's better for larger companies to take advantage of a different tax strategy and simply pay taxes on 70 percent of its gross receipts.

Whiteside said most startup companies are exempt from the tax because they have less than $1 million in gross receipts.

“This change,” she said, “helps the ones who are gaining speed.”

Eliminating the tax cliff is praised in most quarters, but it won't end the debate about whether to phase out the business tax altogether.

Dick Lavine with the Center for Public Policy Priorities said he understands the argument for eliminating the tax cliff.

“It's probably a better design because you avoid the $1 million mark,” he said.

“We felt they could have done more,” he said of state legislators.

Newton said he objects to the tax because businesses owe it whether they are making a profit or not.

He said his organization will lobby next year for a “no-profit, no-pay” provision as well as an attempt to phase out the business tax over several years.

Newton said eliminating the tax overnight is unlikely because of the hit it would make on state services.

“We don't want to cause a shock to the system,” he said. “A gradual drawdown could be acceptable.”

Lavine said turning the state business levy to an income tax would solve most of the objections.

But Craymer noted the franchise levy attempts to tax both partnerships and corporations, although they treat profits differently.

In a state that doesn't have a personal income tax, Craymer said the question is, “Where does a partner's compensation end and the partnership's profits begin?”

The most frequent complaint, however, is that the margins tax is too complicated.

“Most experts don't understand it fully,” Newton said.

Craymer said, “It would be a better tax if it was simpler and everyone paid it.”

Whiteside, the CPA, agreed. “It's confusing how they decided what's deductible and what's not,” she said of state lawmakers.

After the Legislature created the margins tax in 2006, Whiteside said some of her

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