

Tax-saving, Innovative Incentives for Small and Medium - Sized Enterprises in Hungary

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Abstract

The small-and medium-sized enterprises in the Hungarian economy have been playing a decisive role. Among the difficulties they face during their activities one of the most serious is to raise funds for their labour costs. They try to reduce their tax wedge burden, which is regarded one of the highest in Europe, in various ways. In order to keep the adequate workforce they can provide fringe benefits supplementing to wages and salaries. The cautious application of the referring acts enables companies to motivate workforce and reduce the tax and contribution burdens at the same time. Our research aimed to find an answer how SMEs take these advantages and what factors support or hinder the use of the system.

Keywords: labour costs, benefits, tax optimisation, motivation

SMEs in Hungary

In recent years, the fundamental structural characteristics of SMEs have undergone only a small change in most areas. Due to the high labour costs and low capital investments, they do not operate with the appropriate efficiency. In Hungary almost two-thirds of the employees belong to this sector. SMEs contribute to the GDP by nearly 50%. 40% of their revenues are realised by large corporations, 20% by medium-sized companies, and a further 40% by small and micro enterprises. The business structure of the Hungarian economy is similar

to that of the developed market economies. However, the performance of the domestic SMEs seriously lags behind the EU average. By strengthening they could have a considerable stabilising function in the national economy.

The problems of employment

The rate of employment by far lags behind the European average. The small activity of the labour market is influenced by a lot of factors. They include the low employment level of people over 55, women (especially with small children), those living in small settlements and/ or in regions with disadvantage, people with low educational level, as well as, first of all, due to the extension of study periods, people under 25.

It is also a common problem that employers reduce their labour costs, which are regarded quite high in comparison with other countries, by decreasing the working hours – mostly on paper. Analysing data from recent years the national tax wedge is one of the highest [Borsi B. - Farkas L. - Udvardi A. - Viszt E., 2009]. The tax wedge shows the proportion of taxes and contributions in relation to the total labour costs, therefore this ratio can be a decisive factor in terms of competitiveness. For example, in Austria only incomes over 7,500 euro has a larger burden than in Hungary [Ambrus Attiláné, 2010]. The supporters of the tax reform for reducing the tax and contribution burdens argue for its beneficial effect on the employment, although the relation of cause and effect is more complex. SMEs lacking capital are on an inescapable path; therefore - in addition to a weak attitude toward taxation - a part of employers reacts in a peculiar way: they get the necessary staff from the grey or black economy. Their employment “policy” is fundamentally determined by the fact that they are not able to or willing to take the excess burdens, thus they declare fewer employees than they have in reality, in lower working hours and/or at lower wage.

A special group of labour costs: the cafeteria

For employers there is a legal solution to supplement wages in a cost-effective way, with the implementation of which employers may give several fringe benefits to workers from the available resources.

Cafeteria is an English word meaning self-service restaurant. In Hungarian technical jargon its meaning can be best described by the following definition: it refers to the flexible system of fringe benefits

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that can be chosen. In practice, eligibility and the flexibility of the system do not always prevail. Employers and employees, first of all, prefer those possibilities which require less tax and contribution.

The 4 most important factors affecting fringe benefits [Poór J., 2007] include:

- Legal regulation
- Social aspects
- Management aspects
- Tax regulation

The social so-called income supplement function may play a role in sectors offering lower wages, (as it is not a benefit in proportion to wages, it “compensates” people with lower incomes). In the Hungarian practice it has a more decisive effect on tax optimisation and loyalty.

Cafeteria has been an organic part of the Hungarian wage system since 1996. First, it was used for replacing and modernising in-kind benefits, among which payments into voluntary pension funds had utmost importance. Its application was largely affected by legal regulation: the Act on Personal Income Tax Section 69, Clause 1 Paragraphs d)-e) provided tax exemption for employees with 400,000Ft maximum wage per annum. Compared with the previous system, a great advantage of cafeteria was the fact that it enabled employees to choose within the limits of the ensured sum as opposed to the inflexible in-kind contributions [Kovács P., 2009].

When launching the cafeteria system companies did not use any additional resources; they ensured coverage for the individual limit amounts by regrouping the existing benefit expenses. However, the possibility of choice in itself meant a positive change for the employees.

The application of the cafeteria system also enabled companies to differentiate among workers. Groups can be formed according to the type of the labour contract (for definite or indefinite time), full or part-time employment, or the actual state (being active, on long-lasting sick-leave, unpaid holiday, or child-care leave).

In general, the cafeteria system is set by employers in a way that they remain within the limits exempt from taxation. The more complicated systems also consist of 8-10 elements and operate in a flexible way, although the majority of companies cannot afford them.

Among the currently used models the most popular is to choose from packages due to the easier administration compared to other ones. The more simple versions comprise fewer elements and are determined in the same way for each employee concerning both the amount and type of benefit.

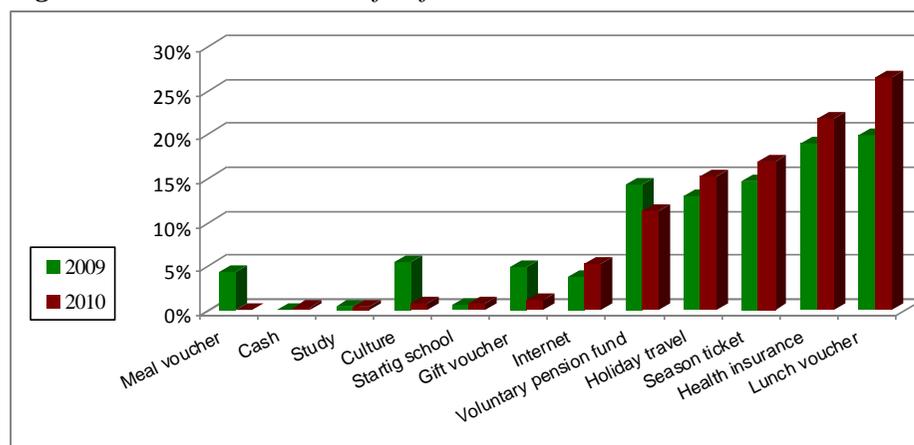
Tendencies of using cafeteria in practice

In spite of the fact that a large proportion of companies' expenses is made up of wages and their contributions, approximately 50% of companies take advantage of the cafeteria system.

One of the largest problems is missing information. In 2010 Hungarian companies were questioned about it¹. By examining their answers we have known they need advising very much [Kaufman, 2011].

Among fringe benefits the supporters of the cafeteria system explain its introduction by cost efficiency, tax optimisation and motivation. Adapting to the changes in the 2010 tax regulations clearly indicates that among the above listed factors efforts to reduce tax have a leading role. Companies reacted to the changes by reducing the amount, transferring the increased tax burdens (at least partly) to the employees, and regrouping the "package", of course, by increasing the proportion of benefits with more favourable tax conditions.

Figure 1: The distribution of cafeteria elements within the annual limit



¹ TÁMOP 4.2.1.B-09/1/KONV-2010-0006 Szellemi, szervezeti és K+F infrastruktúra fejlesztés a Nyugat-magyarországi Egyetemen című projekt keretében folyó kutatás

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Source: Survey by NEXON Kft.²

Figure 1 shows a fall in elements and other facilities the tax and contribution burden of which is higher than it was the previous year. Only those companies took on the excess burden as a result of changes in law where cafeteria is regarded as a tool for motivation [Ambrus Attiláné, 2010].

The statistics of the survey made by NEXON Kft. in 2011 shows that compared to 2010 the average cafeteria limit amount has decreased by 10%; it hardly exceeds the 2009 amount.³ The fall is often due to the fact the employer reduced the amount of fringe benefits when deciding on keeping the workforce. However, a part of companies is reluctant to use the cafeteria system, first of all, due to the related administration burden and their costs. There are also benefit elements with little administration which can be used efficiently [Fata L., 2008]. The launch of fringe benefits is also made difficult by the fact that the exact knowledge of the terms and conditions requires great care and the complex study of several acts and governmental regulations. A key to the successful introduction of cafeteria is IT background closely related to the system. Companies developing and trading with office management software – being aware of the possibilities – are constantly enlarging their choice. As based on experience, cafeteria is, first of all, based on reducing tax, the dynamic change in the legal background forces software users constantly supplement and renew these at additional costs. Companies can choose from different construction according to their needs and on the basis of their resources: renting, leasing, outsourcing or the so-called cloud hosting service.

Adapting to the constant change in tax regulations is not an easy task for companies. No doubt, the strict conditions also hinder the spread of cafeteria systems. In 2010 the different taxation of cold and warm meal vouchers caused some problem; the actual measures affect the holiday vouchers. Favourable taxation cannot be implemented for holiday vouchers issued after 1st October 2011, thus if the employer is not willing to pay excess tax, it has to change the cafeteria limit. The

² http://hvg.hu/kkv/20100427_melegetel_udulesicsekk_egeszsegpenzta

³ <http://www.nexon.hu/cafeteria-tendenciak>

Széchenyi Recreation Card (SZÉP Card) replacing the holiday voucher will provide not only holidays but also health preserving services and it can also be used instead of the previous culture voucher (e.g. theatre ticket, entrance fees into museums).

According experts the main obstacle to the spread of the card is the fact that paper-based vouchers may be used in more places by employees. Employers would not mind its use; therefore service-providers accepting the card are continuously widening their choice.

Based on the above mentioned facts, it is actually clear why more SMEs do not join the circle of the users, in spite of the fact that for them it would be utmost important to take advantage of the benefits of cafeteria. For investigating the relationships primary research has been carried out, whose findings will be detailed in the following chapters.

Research method

Following the secondary research a survey based on questionnaire was made in the 4thQ of 2010 in which Hungarian companies were questioned about their cafeteria systems and the factors affecting them.

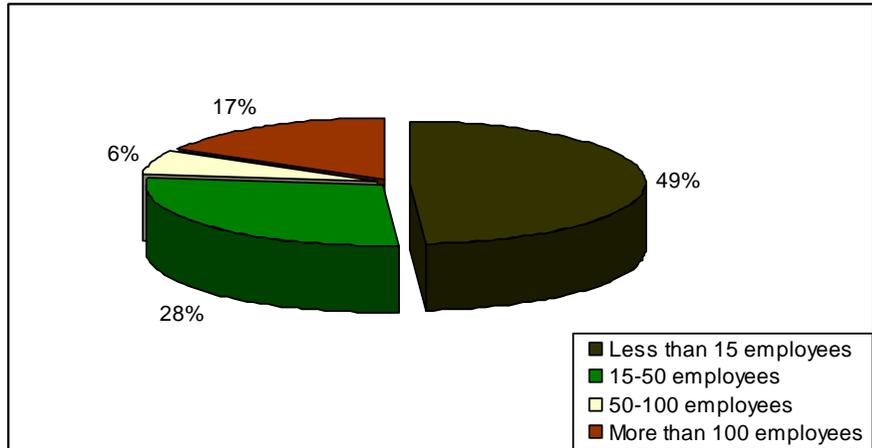
751 companies were involved in the survey (based on the national mailing list). With the help of the Lymesurvey programme the link of the questionnaire was sent out to the e-mail addresses. The responses were processed by SPSS, software for statistical analysis. The survey can be regarded representative, because out of the contacted companies 156 filled in the questionnaire, out of which 141 could be evaluated. Approximately 60% of the respondents use the cafeteria system.

92% of the responding companies were established 5 years ago; only 2% were founded within a year. 32% of the companies had the same revenue, 34% reported about an increase and the same percent about a decrease in revenues.

Regarding the number of employees the responding companies reflect the national distribution (Figure2). 33% stated that they had reduced the number of their employees in the past 3 years, while 20% had raised it.

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Figure 2: *The number of employees at responding companies*

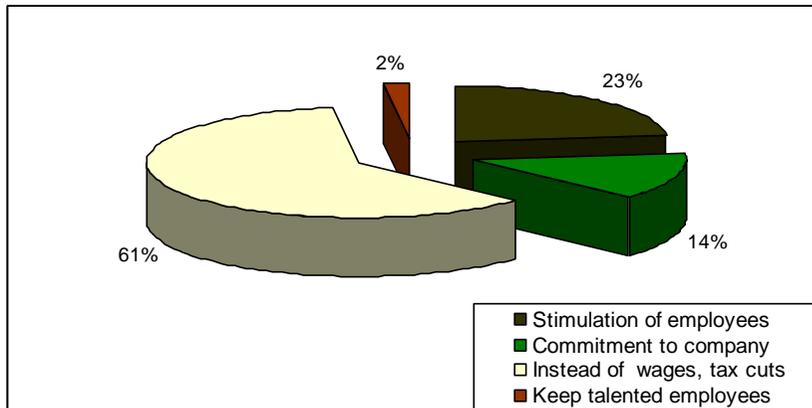


Source: Primary research, survey with questionnaire

The findings of primary research

Cafeteria benefits are provided by respondents instead of pay rise due to more favourable taxation. According less than 25% of the respondents regarded it as an aim to motivate workers, 14% as an aim to increase commitment.

Figure 3: *The most characteristic aim of cafeteria at the responding companies*

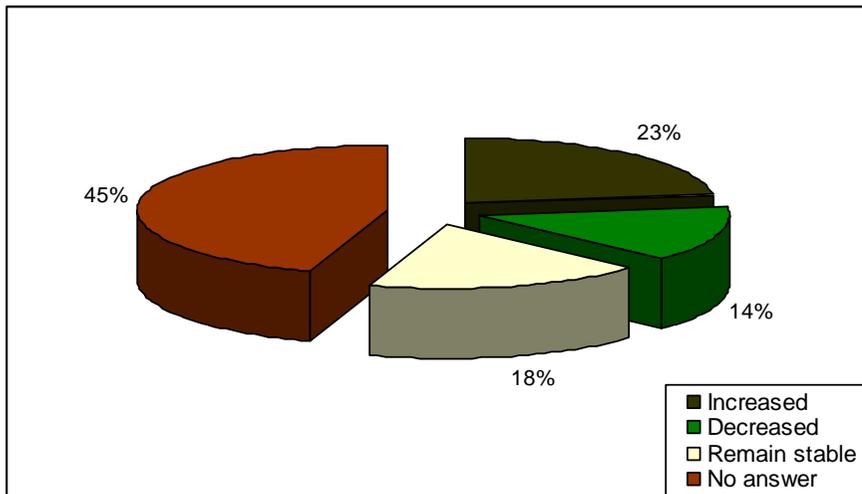


Source: Primary research, survey with questionnaire

Based on the above facts it does not seem surprising that only 16% of the companies differentiate cafeteria benefits, 59% provide the same benefits for their employees (25% did not give an answer).

The priority of tax conditions is supported by the fact that 62% of companies' decisions were influenced by the changes in tax laws, while 38% did not change the previous system (due to them). Companies which adjust their packages to the changes in tax laws do not follow the same direction. Many of the companies increased their cafeteria benefits, a part of them decreased them, while 18% did not modify the sum, only the type of vouchers (unfortunately, 45% of the companies did not answer this question).

Figure 4: *The effect of tax laws on the annual cafeteria limit*



Source: Primary research, survey with questionnaire

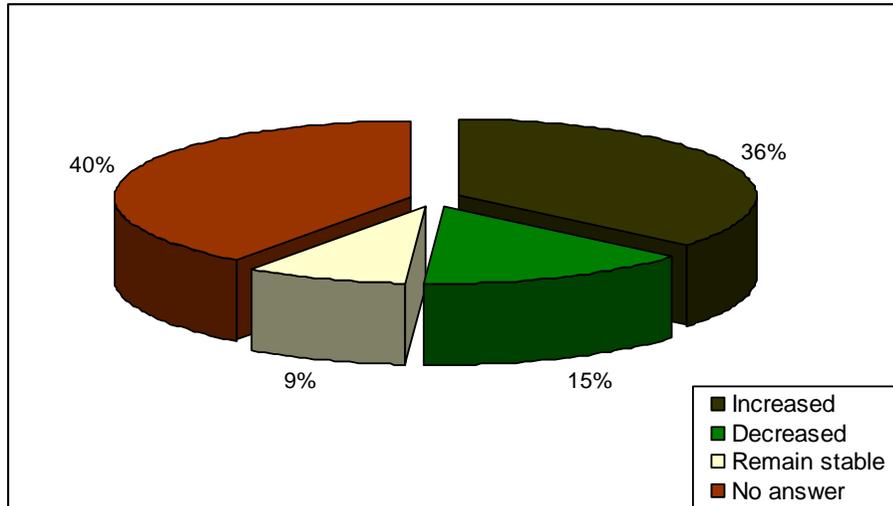
In the past 3 years lunch vouchers have been the most popular cafeteria element, followed by holiday vouchers and travel vouchers. In case of the majority of respondents (69%) administration excess burdens have not affected decisions on cafeteria.

In the examined period 51% of the responding companies kept their annual cafeteria limit unchanged, or increased it (Figure 5) even in spite of the fact that the tax conditions of fringe benefits have

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strengthened. The difficulty due to the financial crisis encouraged companies to think over the structure of their expenses.

Figure 5: The change in the amount of fringe benefits in the past 3 year



Source: Primary research, survey with questionnaire

The number of companies introducing cafeteria is not expected to grow significantly, because among companies without cafeteria service at the moment, only three stated they would have the intention of launching it.

Evaluation of data

Based on the responses to questionnaire, cross tabulation analyses have been made with the help of SPSS software, the overview of which enabled us to find the following relationships:

1. Companies which are more than 5 years old use cafeteria benefits in a much larger proportion than younger companies. These companies introduced the fringe benefits when they were exempt from tax and contribution, and by increasing the tax burdens they have not withdrawn them from the employees. At these companies cafeteria has remained a part of the benefit package in general, but due to the changes in the conditions, it has undergone a significant change.

2. There is also a strong relation between the number of companies' employees and the existence of cafeteria. While in case of companies employing less than 10 workers the introduction of cafeteria is less frequent, in case of companies employing more than 100 people the proportion in terms of cafeteria is considerably larger. More employees require a more rational human resources management and an adequate administrative system, smaller companies more often lack these.

3. A larger part of companies do not provide cafeteria on by differentiation. Among the vouchers lunch vouchers play the most important role. Findings have also revealed that in most cases pay rise is substituted by this method and for the sake of differentiation lunch vouchers are supplemented by further vouchers (travel, Internet). The cafeteria package is the most complex if the major aim is motivation.

4. The amount of the cafeteria limit and the content of the package have been influenced to a larger extent by amendments in laws than the changes in revenue. An increase in revenue does not involve a parallel growth in cafeteria benefits, whereas in case of stable or decreasing revenue, it would be reasonable for companies to establish an adequate cost structure.

Conclusion

The development of the cafeteria systems is influenced both by internal and external factors. Among the external factors there should be a special focus on the legal environment, while among the internal ones the number of employees, the corporate culture, and the IT background play a decisive role. The introduction of the majority of benefits is related to the advantage of the more favourable tax conditions; the aim to motivate workers is often pushed into the background.

For SMEs it is a difficult task to raise funds for the labour costs. In addition to the low tax morality, the black and the grey economy is often regarded as a possible way to preserve and achieve competitiveness. The cafeteria system means an alternative for reducing tax and costs legally; its launch (and maintenance) also depends on companies' load-bearing capacity. Within the framework of the new Széchenyi Plan, in addition to new machines and equipment, micro-, small- and medium-sized enterprises can apply for subsidies to develop information and communication technology. In addition to giving of

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advice is important. A wider use of fringe benefits may only be possible if the legal environment is stable and predictable.

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