

# The cafeteria system in Hungary: past, present and future

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*Cafeteria is a unique form of flexible benefits systems which emerged as a consequence of particular regulations of tax- and social security contributions in Hungary. The system was invented when tax reliefs were provided for certain benefit provisions to serve economic and social goals. From the beginning of next year significant changes are expected to take effect related to the taxation of benefits. This will require employers and benefit providers to adjust their strategy and update their policies. The coming change prompted the analysis of the evolution of the cafeteria system from 1996 until today, especially the drivers of the key changes and the facts how the key players (employers and providers) adapted to the changes. We also look into the expected direction next year and its impact on the benefit policies of employers, and also offer some alternatives to consider as a response to the challenges of the changing environment.*

*Keywords: flexible benefits, compensation, taxation of benefits, Hungary*

## 1. Introduction

Cafeteria systems appeared in Hungary in the 90's and since then they became widespread, the majority of the employers offers them as part of their compensation package.

It is important to the employers that the cafeteria system contributes to the competitiveness of the compensation package, thus increasing the commitment and satisfaction of their employees. Another important factor is the cost effectiveness of the system versus other compensation elements, such as cash compensation. Therefore, employers keep adopting their packages to optimize to the regulatory environment at any given time.

Despite all efforts on designing and communicating total compensation packages, Hungarian employees still focus on cash compensation, especially on the guaranteed elements. However, the cafeteria systems are popular, the limited usage and the time constraint of use still makes people focus on cash.

The government also influences the preference of benefit provisions through tax- and social security regulations in order to support macroeconomic and social purposes, changing the regulations each year. In 2012 further changes are expected to transform the cafeteria system.

Despite the taxes and the constant changes it could be still feasible to maintain the cafeteria system for employers as long as they can optimize the prevalence of HR goals and cost effectiveness in the ever changing environment.

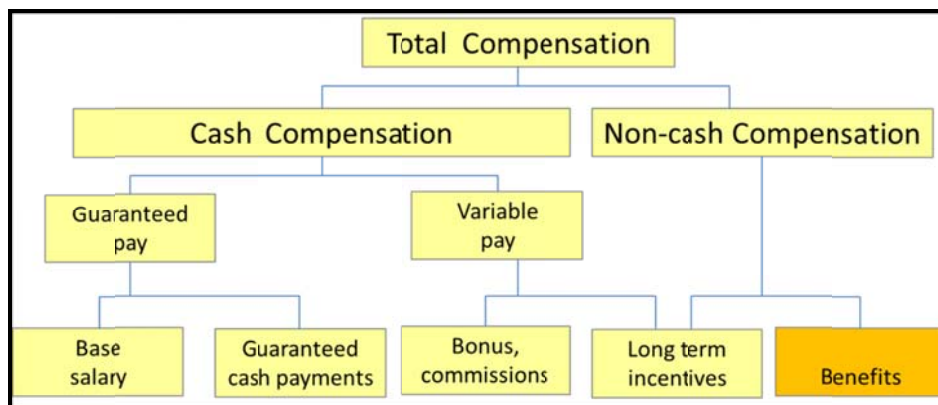
In this study we look back to the history of cafeteria system in Hungary from the early 1990's until today. We also introduce a recent research on how employers provide cafeteria benefits in Hungary today and how they perceive the future of cafeteria. Finally, we look into the expected directions next year and its impact on the benefit policies of the employers.

## 2. Cafeteria benefits

### 2.1. Origin of flexible benefit plans

Benefits are only one part of the total compensation. A broader definition sees benefits as “part of the total compensation package, other than pay for time worked, provided to employees in whole or in part by employer payments” (Milkovich et al 2011). There are some key characteristics which differentiate the benefits from other compensation elements: it is a non-cash, not linked to individual performance, aimed to increase employee satisfaction and commitment and the improvement of competitiveness of the compensation package.

Figure 1. Benefits in the total compensation structure



Source: Mercer (2004)

According to the flexible approach (cafeteria benefits systems) some compensation elements were invented in the US where it widely spread in the 70's and 80's, especially in the area of benefits. It means that there is a “menu” of possible benefit provisions and related costs, and employees can choose the elements they prefer within the available allowance. This allows employees to optimize the benefit package to their lifestyle and preferences (Fragner 1975). This way the perceived value of benefits may be maximized. These systems became very popular among employees however, it also required additional admin efforts and costs by the employer.

Advantages of such flexible systems included the possibility of individualizing the benefits package by employees, which became an important consideration as the war for talent became fiercer, and the attraction and the retention of the employees put more emphasis on the individual. Outside this there were other advantages, such as improved cost control by the employer or the ease of harmonisation, e.g. in the case of integration of two organisations (e.g. during M&As).

These plans were implemented in the UK in the early 80's to address the changing workforce, such as the presence of more women, minorities, single parents or part time workers (Meyer 2000), and became widespread in the 90's, especially in the UK and Ireland. Later the flex systems became widely used in Europe (Poór 2007). Although it started to gain presence in Asia, it still has large potentials as the employment trends are changing there, as well (Chow 2011). In the US there is a wider range of flexible elements, including salaries and equity provisions (Halterman 2000), whilst in Europe due to the different regulations and state provisions flexible plans are structured differently (Culbreth et al 2009).

## 2.2. The evolution of benefit plans in Hungary

Prior to the market economy, employers in Hungary provided wide range of benefits. These were mainly social provision, such as usage of the company's holiday facilities, subsidised meals in the company's canteen, health & safety related provisions or company products).

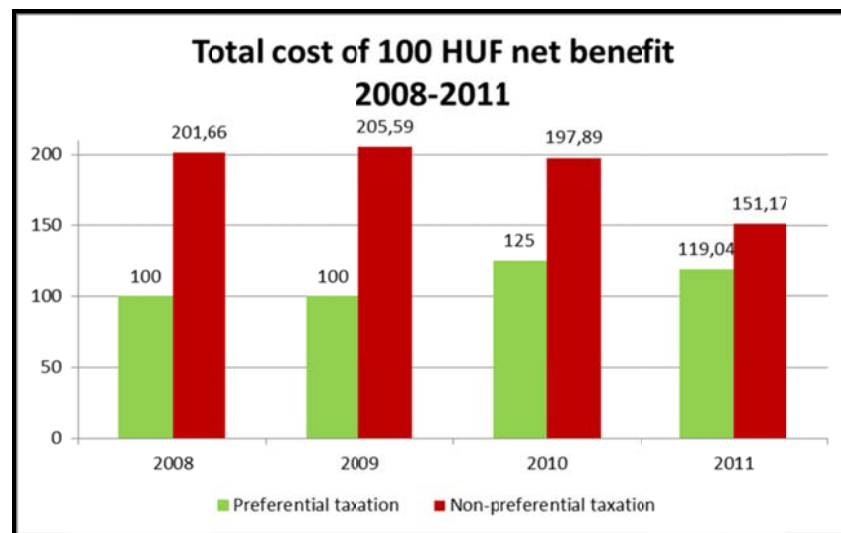
After the introduction of the personal income tax in 1988 the wages were grossed up, but the benefit provisions remained tax free, providing a clear cost advantage for these benefits.

During the privatization of companies, especially those with foreign ownership, the role of benefits was re-evaluated in the total compensation package. International companies attempted to implement their compensation philosophy regarding base pay, incentives, as well as benefits – they adopted their approach in the Hungarian regulatory environment. The range of provisions was still based on the heritage of the pre-market economy era.

Later vouchers appeared instead of direct subsidising (e.g. meal vouchers, vacation vouchers). In parallel with this, providers of benefit services entered the market offering not only the vouchers themselves, but also professional advice, infrastructure and administration services.

Government influence on benefit choices also became prevalent. The government limited the tax exemption to a defined range of benefits which were supported, and imposed high tax to the rest of in kind provisions. Later each year the range and the maximum tax-free amount of benefits were slightly changed. In 2010 a preferential tax rate was introduced to all benefits which were not required by the law and previously were tax-free. Figure 2 shows the changes of the total cost of benefits between 2008 and 2011 as the tax and the contribution rates were changing each year.

Figure 2. Tax impact on net benefits 2008-2011



Source: own construction

There is rationale why employers implemented benefits packages variously. One end of the spectrum (typically employers in highly cost sensitive industries or with lower paid employee base) wanted to maximize the tax advantages, some even offered benefits in lieu of salary increases. Others aimed to implement a strategic compensation approach (often stemmed from the mother company) with main focus to attract and retain the best people on the market – cost considerations were also important in these cases.

Flexible plans were adopted early in the privatisation era in the 90's, not only by international companies, but large state-owned employers also introduced such benefit packages. Gradually cafeteria benefits were widely spread in Hungary.

Several variations came into practice. Most companies kept a fixed provision, i.e. provided the same fixed benefit elements to the same employee groups. Others defined a range of core benefits and provided flex choice to the larger part of the allowance, or gave a fully flexible allowance to employees.

### **3. The research**

#### *3.1. Background*

The Management and HR Research Centre at Szent István University and Larskol Consultants carried out a research where they looked into the effect of the economic crisis and the changes in tax and social security regulations on the cafeteria policies of the employers.

Participation in the research was voluntary and free of charge, and data were handled with appropriate confidentiality and security. The technique of the data collection was web-survey.

The research is based on a questionnaire with 10 sections:

- basic data of the participating firm,
- the descriptive features of the firm,
- the benefit systems applied at the firm,
- guaranteed benefits,
- flexible benefits,
- considerations related to operating the cafeteria systems,
- cafeteria allowances,
- cafeteria systems after the changed tax environment in 2011,
- willingness to implement a flexible system where it is not available,
- future of the benefits in kind.

In the study the conclusions were based on descriptive statistical features such as averages, frequencies and distributions.

Out of the 221 completed questionnaires, there were 176 validated. The research was benchmark type, which intends to provide basis for comparison for future research. In addition, it intended to get a snapshot on how companies perceive the role of benefits in the current environment.

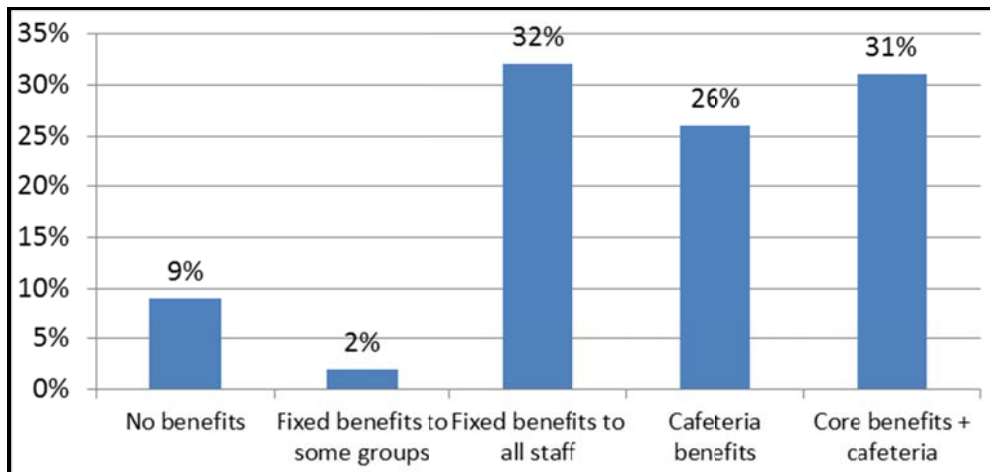
Although the sample is not fully representing the Hungarian employers, the list of the participants includes some major or leading organizations, and also a variety of sectors and sizes are represented, therefore, the results illustrate the tendencies in benefits policies.

#### *3.2. Key findings*

In this section we introduce the most important findings from the detailed analysis of the data.

92% of the respondents offer some kind of benefits outside the wages. However, only 57% of them provide the possibility of flexible choice to their employees, either with a core + flex or in a full flex package.

Figure 3. Distribution of typical benefit structures

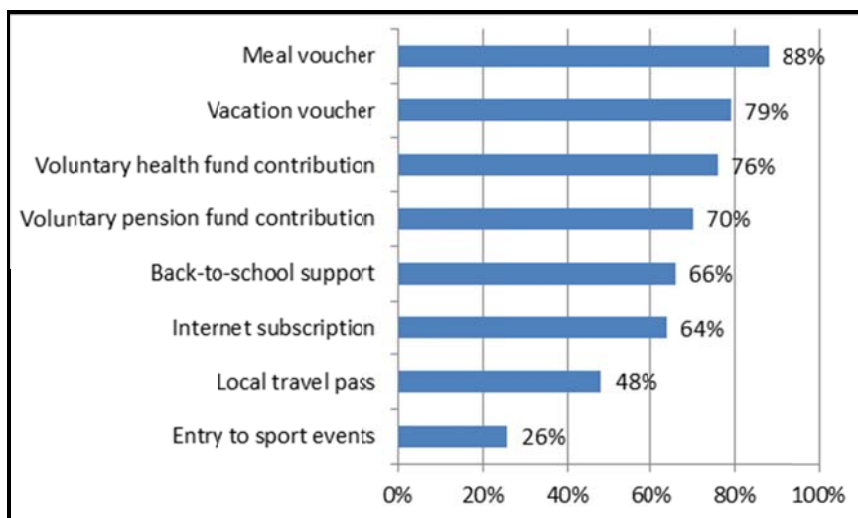


Source: own construction

There is a connection between the size of the organisation and the offering of flexible choice. 70% of the companies which employ more than 1000 people do have cafeteria in place, and only 20% of those companies which employ 10 or less people.

The most popular cafeteria elements are the benefits with the preferential tax rate. There is one new item on the list: entry to sport event, which is not yet widely offered despite it has tax free status, and it did not appear among the most popular guaranteed elements, either.

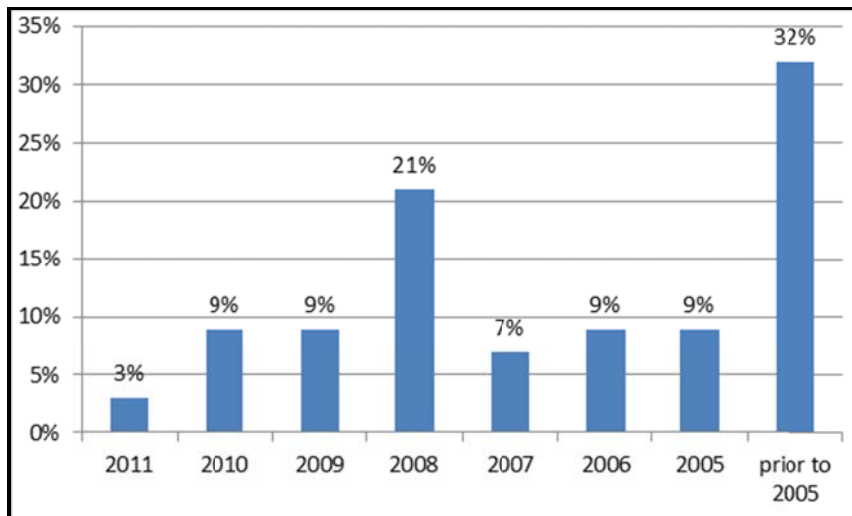
Figure 4. Most popular cafeteria elements



Source: own construction

Regarding the year of implementation, more than three quarter of those respondents who already introduced cafeteria introduced the system before 2009.

Figure 5. Cafeteria implementation year

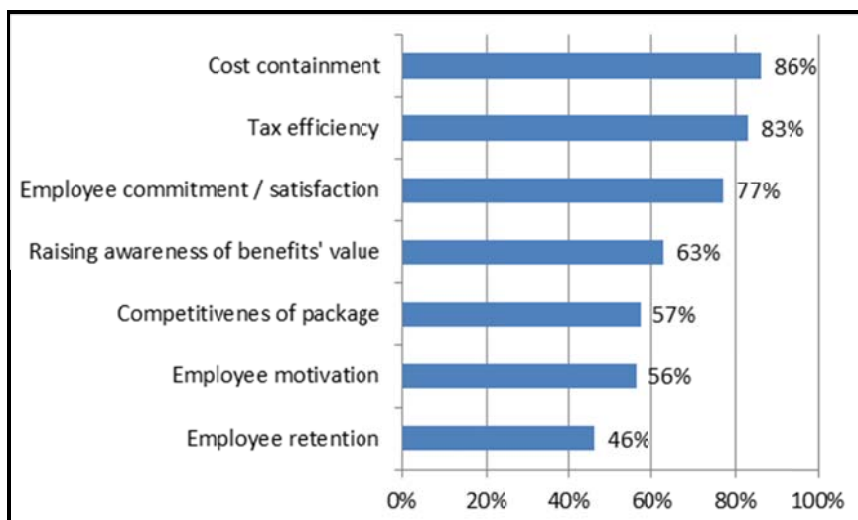


Source: own construction

In the last three years the cafeteria gained presence in the public sector, this was the main driver during the implementations post 2008. Only 11 organisations implemented cafeteria after ceasing the tax exemption on benefits. 45% of these operate in the public sector.

Another interesting point is the main purpose why organisations introduced cafeteria systems. The ability to plan the costs and using the advantages of the tax exemptions are among the leading reasons. The early adopters of cafeteria put far more emphasis on the employee commitment and retention, as well as the employer's reputation, although the cost considerations were also important to them. In the latest implementations the cost related motivation was dominating among the organisations.

Figure 6. Reasons to implement cafeteria



Source: own construction

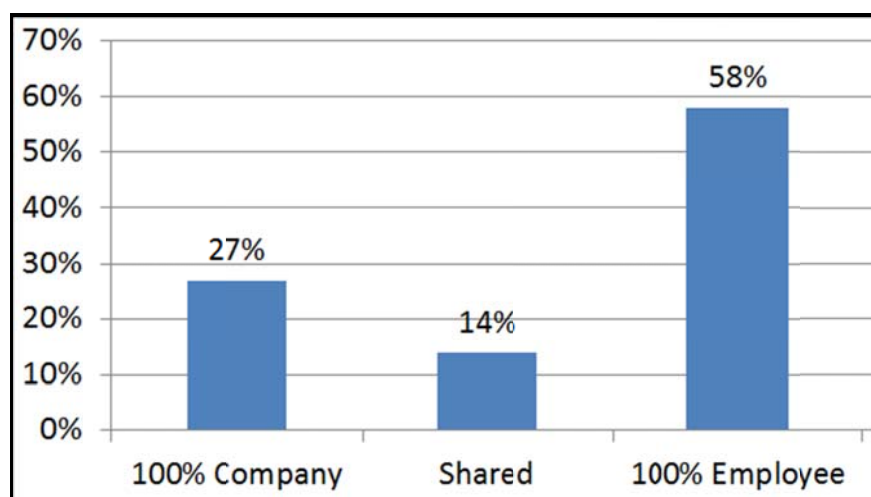
Another surprising finding is that 39% of the respondents never evaluate the effectiveness of the cafeteria system, 42% look at it occasionally, and only 19% of the employers carry out a regular review among which 77% of these companies are large organisations.

As far as the administration is concerned, 87% of the companies operate the system with in-house administration. Outsourcing the whole or a part of the administration is more typical among the large organisations, as well. The most typical administration tools are spreadsheets (38%) and cafeteria solutions integrated into the payroll systems (34%). Only 9% of the companies administer the systems on paper.

### 3.3. Cafeteria and taxation

Before 2010 a range of benefits up to a limit enjoyed tax exemption. In 2010 tax was imposed on these benefits, as well. However, the tax rate was preferential and social security contributions were also not implemented, still leaving considerable cost advantage among those provisions which did not qualify for the preferential tax rate. The tax should be paid and declared by the employer but there is a possibility to pass on the tax burden to the employees. We were interested to see how the companies in our sample reacted to the tax implementation.

Figure 7. Tax payment on cafeteria



Source: own construction

We have found that the majority of the companies passed on the tax burden fully (58%) or partly (14%) to the employees. Only 27% of the companies undertook the additional costs resulting from the taxes.

In 2011 the cost of the preferential tax slightly reduced from 25% to 19,4%. In parallel, 30% increased the available annual amount. However, the majority of companies (57%) kept the allowance of the previous year, and 12% changed it. Our assumption is that all of these reactions could result at least to maintain, in some cases to increase, the net value of benefits to the employees. If the company works on gross allowance basis and passing on the full tax to the employees and the allowance is unchanged, then the employees benefit from the tax reduction. If the company offers benefits on a net basis to the employees (i.e. the company takes all the tax charges), then there is a room for slight increase of the allowance and still maintaining the same costs as in 2010.

## 4. The future of cafeteria benefits in Hungary

Our research supports our hypothesis: 79% of the respondents still think that the provision of the cafeteria benefits is still a compelling proposition due to the savings allowed by the

preferential taxes. 21% of the respondents argued that the cost advantages of cafeteria benefits diminished over time and it is less appealing for them to provide it. The latter view is more typical among the small and medium-sized companies which pay less attention to the potential advantages of providing cafeteria plan.

In 2012 significant changes are expected to the range and the use of benefits with preferential taxation. Although at the date of writing this article the tax laws for next year are not yet known, we anticipated the government's intentions based on a ministry proposal and a related draft governmental resolution (*National Ministry of Economic Affairs* 2011). The key theme of the proposal is to align the tax preferences with the macroeconomic policies: to drive consumption in specific sectors (e.g. tourism), to support social purposes, and to incentivise self-provision (e.g. pension and health care savings).

It is also expected that the total provision as well as the provision of the individual elements with preferential taxation will be limited to a specific amount.

The so called Széchenyi card (SZÉP card) is proposed to be linked to 3 different accounts: one will be the same as the current provision. Most likely there will be a meal account, as well as a recreational account. In parallel with these changes there is an intention to scale out the vouchers from the system, although this may take several years, as the infrastructure for the card usage need to be expanded countrywide. Therefore, we anticipate that the vouchers will remain in place for some period of time in parallel with the SZÉP card. However, based on the proposal, it is expected that in the longer term the state would like to take more control of issuing vouchers or cards representing preferential benefits.

To Incentivise self-provisioning, especially on the area of health care and pensions it is a declared governmental objective. Therefore, the voluntary health funds and voluntary pension funds will remain in the preferential tax category. There are overlapping services between the SZÉP card and the voluntary health fund. It is recommended for consideration to separate the usage of these two benefits, i.e. the recreational part will be taken over by the SZÉP card, and the voluntary health funds may be used only for medical products and services.

The local travel passes will remain in the preferential tax rate. This serves not only social purposes, but also aims to increase the mobility of the workforce. It is also likely that there will be no change related to the "back to school" voucher, and the sport entry tickets will remain tax-free up to a limited amount.

The internet usage will not only lose its preferential status, but it is also likely that it no longer will be qualified as "benefit in kind" for tax purposes, i.e. from taxation point of view it will be equivalent to cash compensation.

An important element for the employers is the cost containment. Organisations control the total compensation costs within which cafeteria is only one segment. However, it is easier to change it than the salaries, which are guaranteed. Therefore, under governmental pressure on employers to compensate the disadvantages of the tax changes through wage increases, in certain employee groups it could lead to reduction of other compensation elements which are above the statutory requirements, such as variable pay or benefits. The reaction to the complex tax regulation changes and its impact on benefits need to be researched once companies re-assessed their strategy in light of all the changes.

Administration costs are other factors to be considered. If the admin burdens require too much effort and costs (e.g. re-configuration of systems, training of benefit admin staff, re-negotiation or conclusion of new supplier contracts, etc.) this could work against the flexible systems. If the administration could be simplified, it could incentivise more employers to consider the implementation of the flexible choice.



## 5. Conclusions

Cafeteria benefits are attractive elements of the reward packages. The flexible choice is valued by the employees. The growth of cafeteria systems in Hungary is continuous since the 90', especially due to the influence of international firms, as well as due to tax advantages.

Cost efficiency is one of the most important criteria employers consider when implementing or reconfiguring their flexible benefit system. Therefore, elements with preferred tax rates prevail. The government expresses its influence on the preferred elements through preferential tax rates for certain elements. In the past years the gap between the preferential and non-preferential tax rates on benefits narrowed, however, there is still tangible difference which makes it feasible for companies to continue the provision of the benefits in the future. However, the regulatory environment goes through a variety of changes in the area of tax, social security, labour law, etc., which requires companies to review their practices through an integrated approach.

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