



## LEGAL COOPERATIVE FRAMEWORK ANALYSIS

### Within the ICA-EU Alliance

### NATIONAL REPORT of COSTA RICA

#### I. Introduction

This report was produced within the investigation of the Legal Cooperative Framework Analysis initiated by the International Cooperative Alliance (ICA) and its regional offices. The investigation is carried out in the framework of an alliance signed between the European Union and the ICA for the 2016-2020 period, which aims to strengthen the cooperative movement and its capacity to promote international development.

The analysis of the legal framework seeks to improve the knowledge and evaluation of cooperative legislation, with the aim of ensuring that legal regulations recognize the specificities of the cooperative model and ensure equal conditions, compared to other forms of association. This analysis will also serve ICA members as input into their advocacy and recommendations regarding the creation or improvement of legal frameworks, to document the implementation of cooperative laws and policies, and to monitor their evolution.

In line with the objectives set out in the ICA-EU Project, this report aims to provide a general understanding of Costa Rican cooperative legislation and an assessment of the degree of its ability to promote the development of cooperatives. Recommendations are also made for the improvement of legislation in order to overcome some difficulties that cooperatives are currently facing.

The document has been prepared by law graduate, Edgardo René Ramos Carmona, a leading professional in the field, with a career of more than thirty years, promoting and guiding the cooperative sector in Costa Rica, he is Senior Advisor for numerous cooperatives and a private litigator. In order to create this document, the contributions made by national cooperative organizations affiliated to Cooperatives of the Americas have been taken into account.

Contributions from the expert and Costa Rican organizations members of Cooperatives of the Americas were collected through a questionnaire prepared by the International Cooperative Alliance and its regional offices. The questionnaire was sent in its entirety to all members in Costa Rica and completing it was voluntary.





## II. National cooperative law of Costa Rica

### i. General context

The first Costa Rican cooperative regulation dates back to 1943; when the first Labour Code was enacted, a regulation was included (Art. 262) which declared cooperatives "as one of the most effective means of contributing to the sustainability and development of popular culture and Costa Rican democracy. This legal definition would later be replicated in the Political Constitution enacted in 1949 with the following regulation: "Political Constitution of the Republic of Costa Rica Article 64.-. The State will encourage the creation of cooperatives as a means to improve the living conditions of workers...".

Articles 293 to 363 of the Labour Code defined the nature of what would become cooperative societies, of indefinite duration, of variable and unlimited capital and limited liability. In this regulation of the Labour Code, no mention is made of the Declaration on Cooperative Identity, as the declaration came after that time.

In the Labour Code, cooperatives also obtained the preferential right for the hauling of food items by the State, a fifty per cent reduction in the costs related to legal proceedings and exemption from taxes and customs surcharges for the importation of equipment related to the industry, livestock, agriculture and food and it was established that, for legal purposes, cooperatives would not generate profit.

These first cooperative precepts in Costa Rica would be part of the Labour Code until 1968 when, by Law 4179, the "Law on Cooperative Associations and creation of the National Cooperative Development Institute -INFOCOOP-" was enacted. Through this law, the Costa Rican cooperative movement would autonomously become established and thus modify the legal nature of these organizations, going from being cooperative societies, to being from then on, voluntary associations of people of an indefinite duration and limited liability. The fundamental aspects of the organization of a cooperative society contained in the Labour Code will be transferred to the new Cooperative Associations Law 4179 and will be incorporated in Article 3<sup>1</sup>, a definition of principles and regulations to which all cooperatives

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<sup>1</sup> Law on Cooperative Associations and Creation of INFOCOOP (Institute for Cooperative Development) No. 4179 Article 3.- All cooperatives in the country shall strictly conform to the following principles and regulations: (a) Free adhesion and voluntary withdrawal of associates. b) Right to voice and one vote per associate. c) Return of surpluses and acceptance of losses by associates in proportion to the operations they carry out with the cooperative according to their participation in the common work. d) Payment of interest limited to contributions made to the share capital. (e) Racial, religious and political neutrality and equal rights and obligations of all associates. (f) Promotion of cooperative integration. (g) Promoting education and social welfare and improving the living conditions of associates and their families. (h) Indefinite duration, variable and unlimited capital, and unlimited number of associates. (i) Limited Liability. (j) Non distribution among the associates of the reserves established by law and of surpluses produced by



must adhered to. These principles and regulations are in response to those formulated in the International Cooperative Alliance XXIII Declaration of 1966.

After 1968 the creation of new legal bodies related to the cooperative sector, would be very few. Law 6437 of April 1980 deserves special mention, which established the teaching of cooperativism within educational centers of the country to be mandatory, Law 7391 of April 1994 called the Law on the Regulation of Financial Intermediation Activity of Savings and Credit Cooperatives and Law 8345 of February 2003 called the Law for the Participation of Rural Electrification Cooperatives and Municipal Public Services Companies for National Development.

## ii. Specific elements of the cooperative law

### a) Definition and objectives of cooperatives.

Article 2<sup>2</sup> in the Cooperative Associations Law establishes the definition and nature of the cooperative organization as a "voluntary association of persons and not capital", which has a democratic organization established with the aim of "satisfying and promoting social economic improvement" where the motivation of the organization is "service and not profit".

The status of voluntary organization of people with non profit motivation, consequently, exempt from income tax, constitutes the main difference between cooperatives and commercial legal entities regulated in the costa rican Code of Commerce<sup>3</sup>, in the capacity of association of persons and not capital, therein lies the difference in the appropriation of the entity. In capital based companies shares independent of their owner or owners make up the legal entity, the holder of one or more shares votes for them, in the cooperative all associates will be equal voters in the higher decision-making, which is the assembly of associates.

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operations with persons who, without being associates, would have used the services of the cooperative and the income not from the social function of the cooperative (k) Autonomy in its government and administration with the exception of the limitations established by this law.

<sup>2</sup> Law on Cooperative Associations and Creation of INFOCOOP (Institute for Cooperative Development) N. 4179 Article 2.- Cooperatives are voluntary associations of persons and not of capital, with full legal capacity, of an indefinite duration and of limited liability, in which individuals are democratically organized in order to meet their needs and promote their economic and social improvement, as a means of overcoming their human status and individual formation, and in which the reason for work and production, distribution and consumption, is service and not profit.

<sup>3</sup>Trade Code No. 3284. Article 17.Regardless of its purpose a commercial entity is: (a) An association under a collective name; b) an association in limited partnership; c) a limited liability association; and d) a limited association.



The Cooperative Associations Law regulates democratic control in three specific regulations, the first in the declaration of principles, which establishes "right to voice and a single vote per associate" (Art.3.b), the second by not allowing the delegation of directive functions to a specific person or management companies (Art.10) and the third prohibiting any associate from intervening in cooperative management, simply for having significant capital contributions or being creditor of large surpluses. (Art.65).

The participation of the associates in economic management, makes them contributors of share capital (Art.66.b), this capital may be subject to interest payments (Art.3.d) and generates the right to obtain surpluses or the obligation to bear debts, in proportion to the operations performed in the cooperative (Art.3.j). The reserves established by Law cannot be distributed as well as the surpluses generated from the operations with non-associated third parties (Art.3.j), these surpluses produced by non-associated third parties increase the education reserve (Art.82).

The autonomy of government and administration maintained by cooperatives is expressly established (Art.3.k) and is particularly reinforced when it is stated that "the actions of private entities or public bodies imposing direct or indirect restrictions are entirely invalid" unto cooperatives (Art.4), unless expressly determined by law.

The Cooperative Associations Law does not consider the concept of "cooperative act"; however, in the article on referral to alternative sources (Art.131), Cooperative Law is mentioned as a generator of the regulatory principles of cooperative activity.

Article 3 of the Law regulates, racial, religious and political neutrality and equal rights and obligations among associates, the promotion of cooperative integration and the education and social welfare of cooperators, as well as the unlimited variability of capital and number of associates.

The Cooperative Associations Law 4179 (with at least four partial reforms) in general, regulates the activity of all cooperative organizations in the country, except Savings and Credit Cooperatives that hold financial intermediation activity because they are specially regulated in Law 7391. This law establishes that these organizations are subject to special regulation in their activity by the General Superintendency of Financial Institutions. This Superintendency classifies the entity that promotes the incorporation of associates through term acquisitions in cooperative instruments as an open cooperative.

There are two basic classifications for cooperatives: the first is related to the activity they carry out (Arts. 15 to 27) being a classification of "numerus apertus" as the National Institute of Cooperative Development (INFOCOOP, for its acronym in Spanish) can authorize the



creation of cooperatives with activities not covered by the law. The second classification relates to the organizational model, which in this case can be classical cooperatives, self-management cooperatives and co-management cooperatives.

Co-management Cooperatives regulated in article 120 of the law, "*..., are those in which ownership, management and surpluses are shared between workers and producers of raw materials, between the State and workers or between workers, producers of raw materials and the State.*". Given the bipartite or tripartite condition of the associative basis, the formation of social structures is carried out percentually in regard to the sectors represented and in the case of distribution of surpluses, the amount of contributions made and the volume of operations carried out by each sector in the cooperative are taken into consideration.

What is known doctrinally and in comparative law as an associated work cooperative, is regulated in the Law of Cooperative Associations of Costa Rica, as a self-managed cooperative and according to article 99 of that legal body a self-management cooperative is an organized company, "*for the production of goods and services, in which the workers who integrate them handle all its activities and directly contribute their workforce, with the primary purpose of carrying out productive activities and receive, in proportion to their contribution of work and economic and social benefits. Production units intended toward their operation shall be under the share property scheme on an indivisible basis.*"

By opposition, a classic cooperative is one that is not organized as comanagement and that is also not self-management, some sectors of the academy identify it as a management cooperative. The concepts of classic cooperative or management cooperative are simply academic and are not manifested in legal text.

## **b) Establishment, cooperative membership and government.**

In Costa Rica, the registration, inscription and authorization to start operations of a cooperative, is granted by the Ministry of Labour and Social Security (MTSS, for its acronym in Spanish), for this purpose the interested parties must provide a study on possibility, viability and profit or feasibility and a certification issued by the National Institute of Cooperative Development, showing the actual payment of twenty-five percent of the share capital that cooperators have subscribed, and must also attach a copy of the cooperative bylaws.



The minimum number of associates for the establishment and operation of a cooperative is twenty people, in the case of self-management cooperatives (associated work) this number is reduced to 12 people, the reduction of the number of associates below the legal minimum is cause for dissolution.

The association and membership in the Cooperative is absolutely free, with the caveat that arises from complying with the requirements established in the Social Bylaws. Withdrawal can take place at any time simply by written communication, only the danger of having the legal minimum of associates can prevent associate withdrawal, it is up to the Board of Directors to approve the entry of new associates.

The principle of one man, one vote, applies to all basic cooperative entities and integration entities, the weighted or proportional vote for higher level entities is not regulated, however, it is not expressly prohibited.

The chapter on administration and operation of cooperatives establishes a basic organizational structure consisting of a General Assembly that can be made up of associates or delegates, a Board of Directors, a Manager and sub-managers (if required), an Education and Social Welfare Committee and a Surveillance Committee; the cooperative entity may establish any other management body to address its needs and characteristics. The law does not establish that members of the Board of Directors may be persons not associated to the cooperative, therefore only associates may be on the Board of Directors and it is expressly prohibited to delegate any management function to certain persons or management companies.

Vote by delegation is presented in two ways, in associate assemblies, attendance and voting can be delegated from one associate to another by simple note, no associate can represent more than one person. In the assemblies composed exclusively of delegates the situation is modified, since each delegate in the assembly will be representing the number of associates established by the Social Bylaws.

The assembly constitutes the highest authority of the cooperative association, its agreements are mandatory as long as they are lawful, it must hold an ordinary meeting at least once a year and extraordinary meetings whenever convened. During the annual meeting the directive body reports and income statement are presented and the members of the Board of Directors, Supervisory Committee and Education Committee are elected corresponding to expiration periods. Management positions may not be greater than four years or less than two years, there is no legal impediment to indefinite re-election.



The Board of Directors is responsible for the senior management of social operations, through agreements that are executed by the Cooperative Manager, it is made up of an odd number not less than five members, who are responsible for their actions or omissions. The Board of Directors is responsible for the appointment of the Manager who will be the person who holds the status of legal representative of the Cooperative. The Law expects the appointment of two alternates for the members of the Board, these shall become part of the governing body when temporary or definitive absences of any owner arise. The consecutive three-session absence of a proprietary director with no just cause constitutes the loss of the director's credential

The prosecution role corresponds to the Supervisory Committee, consisting of a number of no less than three members, the responsibility from action or omission of the members of the Board also reaches the supervisors and the manager, when they have not warned about causal risk.

The Committee on Education and Social Welfare, composed of a number of members to be determined by the Social Bylaws, is responsible for cooperative education and the promotion of the association and its values, likewise it is responsible for the social promotion programs that are financed with the corresponding reserve.

The manager, in their capacity as a legal representative, executes the agreements of the Board of Directors and manages the cooperative's business. In order to remove the manager, the Board of Directors requires a qualified majority of two-thirds of the members of the Board.

The way in which the management entities take the agreements is not determined in the Law, that corresponds to the internal regulation of each cooperative.

### **c) Cooperative financial structure and taxation.**

In Costa Rica, no minimum amounts of share capital contributions are established to form any type of cooperative. As determined by the Law, the association's bylaws establish the minimum number of contribution certificates that an associate must contribute to be part of the cooperative, these contribution certificates are nominative, indivisible and transmittable only through the Board of Directors. These certificates may not be less than fifty Costa Rican colones (approximately US\$0.087) or greater than two hundred Costa Rican colones (approximately US\$0.35).

The cooperative board can approve increases in capital contributions if required, only financial cooperatives (savings and credit) can issue investment certificates or specialized financial products, to be placed only among associates. The issuance of negotiable



obligations among associates or non-associated third parties is prohibited for other cooperatives.

Certificates of contribution are not seizable, except for cooperative creditors, within the limits of social responsibility. In the event of a loss of association, the former cooperator will be able to receive the contributions paid up to the time of the resignation. In case of losses, the former cooperator will be deducted the corresponding proportion in said loss, and if the cooperative has debts, compensation in favor of the association shall apply.

The remuneration of capital contributions from associate withdrawal has no limit, however, the cooperative must establish at a statutory level, a percentage of the social contributions to be allocated to the return of the capital paid by the associates at withdrawal. Once this annual percentage has been covered, other unpaid former associates will have to wait for the following periods for settlement, following the order of their resignations. The outgoing associate shall also be entitled to the percentage of surpluses that have been submitted at the time of the resignation, the payments of these items are made after the General Assembly approves the profit and loss statement on the appropriate date.

Once parafiscal obligations are covered, surpluses are allocated by their order to constitute; legal reserve (10%), education reserve (5%) and the social welfare reserve (6%), in the case of self-management cooperatives (associated work) the following reserves should be added; productive investments (15%), national fund for promotion; and training (4%), fund for the strengthening of self-management cooperatives, this fund is conceived as a financing alternative for projects developed by these cooperatives. The remaining balance after the application of reserves will be distributed among the associates or capitalized if that is determined by the General Assembly, its distribution is made by weighting the use of the services and the contribution of capital by a factor that must be approved by the Assembly.

In the event of a dissolution and liquidation, the total social credit is applied as follows; a) Covering workers' wages and benefits, b) Covering the association's debts, c) Paying the value of the contribution certificates to the associates and d) Distributing among the associated surpluses or interests that may have been accrued up to the final liquidation.

The Law of Cooperative Associations states that these associations have no profits, for this reason the balances in favor that arise after the tax period, are savings or surpluses that belong to the associates and are not subject to income tax. Even when cooperatives do not pay income tax, they do have to pay two parafiscal obligations from their surplus, these payments are for the National Council of Cooperatives -CONACOOB (for its acronym in Spanish) - (2%) percentage that can be reduced by 1% if it belongs to a second-level entity and to pay





the National Center for Cooperative Education -CENECOOP- (for its acronym in Spanish) (2.5%) percentage that can also be paid with education reserve resources.

Cooperatives, as entities working in the domestic market, are required to pay taxes arising from the activities they carry out, such as sales taxes, value added taxes, consumption taxes, capital income taxes (in this case with preferential treatment compared to other financial operators) commercial patent payments, etc.

The Costa Rican tax administration has recently established that the per-session allowances paid to members of the Board of Directors, Supervisor Committee, Education Committee and any other social entity are subject to Value Added Tax rated at 13%, likewise the surpluses distributed to associates in any cooperative and the term investments of savings and credit cooperatives, are taxed by the income tax, in the latter two cases, the cooperative acts as a tax retention, as the taxable person is actually the associate.

#### **d) Other specific features**

In Costa Rica the regulation of the activity carried out by cooperatives is subject to the controls of their business activity by the State. These controls range from the supervision of financial intermediation in the case of savings and credit cooperatives, up to health controls, product distribution, production or administration requirements of public or private goods and services, or any other control necessary to participate in the national economy. In regard to the commercial or service business developed by cooperatives, these entities may be sanctioned just like any other operator in the country's economy.

The Law on Cooperative Associations grants the National Institute of Cooperative Development (INFOCOOP) the obligation to ensure that cooperatives comply with the legal provisions that regulate them, however, this same law does not grant INFOCOOP sanctioning or interventional authority. In this circumstance, self-control derived from the autonomy of the associative will is what, with the exception of savings and credit unions, prevails in these organizations. Savings and credit cooperatives can be the subject of intervention by the regulatory body.

Only the Law on the Regulation of Financial Intermediation Activity of Savings and Credit Cooperatives, provides the possibility of establishing concurrent supervision between the cooperative federations and the general superintendency of financial entities (SUGEF, for its acronym in Spanish).



Second level entities are the vehicle for implementing the principle of cooperation between cooperatives, these entities can be federations, unions, confederations and auxiliary bodies. Federations can be made up of at least five cooperatives of the same social activity, cooperative unions can be regional or national in nature, and must be made up of at least five cooperatives of different activities in order to be created. Three national confederations are foreseen.

As of 1987 the Law introduced the Auxiliary Agency of Cooperativism, which can be made up of two or more cooperatives, one or more cooperatives and State institutions, or one or more cooperatives and private entities of a non-profit nature, the regular provisions of the Cooperatives Law apply to these auxiliary entities. These auxiliary bodies are created with "the sole objective of promoting and developing the cooperative sector through the provision of technical, financial, economic, social, audit and research services" (Art. 95).

In 1994, when the Law on the Regulation of the Financial Intermediation Activity of Savings and Credit Cooperatives was enacted, Cooperative Societies were born, which may be constituted by two or more cooperatives of this nature or a savings and credit entity and a cooperative integration entity. Cooperative Societies are established in order to provide financial services to their associate entities. The Cooperative Society is conceived as a figure intended to facilitate the development of integrated businesses among the cooperatives that make it up, its administrative structure does not have to be the same as a cooperative, they are not obligated to pay the parafiscal contributions that are levied on other cooperatives and should only form a legal reserve.

### III. Easiness of national law for cooperatives

In Costa Rica there are no specific legal barriers or obstacles for the development of cooperatives, on the contrary, public policies and legislation in general are inclined toward the development of these associations. However, the Cooperative Associations Law requires comprehensive reform in order to adjust it to the reality currently brought forward by the cooperative movement. The current law was encouraged by the development of cooperatives, especially agricultural ones, with emphasis in coffee activity and the production for the consumption of basic grains. The current reality shows a movement that without abandoning agriculture, is inserting itself into other sectors of the economy, which requires a regulatory update.



The National Institute of Cooperative Development (INFOCOOP), is the public entity responsible for the promotion and dissemination of cooperativism. The Board of Directors of the institution is composed of seven directors, three of whom are appointed by public entities, mainly, a representative of the National Bank (State commercial bank), a representative of the Ministry of Labour and Social Security and a representative of the Ministry of Agriculture and Livestock. The cooperative movement has the right to choose four directors, who are appointed by the National Council of Cooperatives (CONACOOB).

The National Council of Cooperatives (CONACOOB) is the leading entity of the sector, by law it is a public, non-state entity, it acts as a national confederation and is financed with 2% of the liquid surpluses of cooperatives, this being a required parafiscal obligation.

The Cooperative Associations Law states that these associations will have preferential treatment to hire with the State; however, the public procurement regulation does not consider that possibility, public procurement offers place all bidders and interested parties under equal conditions with State-related contracts.

#### **IV. Recommendations for the improvement of the national legal framework.**

It is important to ensure that in the cooperative legislation and in the rest of the positive order of the country, the cooperative act is recognized, with its fundamental characteristics and that the actualization of the Law on Cooperative Associations be derived from there.

New regulation that allows novel schemes is required for the capitalization of organizations, and it is necessary to regulate the procedures within cooperatives to modernize and facilitate the summons and execution of assemblies and meetings of administrative entities. Special regulation should be established for cooperatives that manage or distribute public services such as electricity, infocommunication services, health services, education services, etc. It is also important to standardize in a particular way the existence of housing and consumer cooperatives, which have seen a reduction in the country.

The concept of cooperative as a voluntary association of people and not capital, has been reduced, as it is not conducive for companies of significant dimensions, such as those exhibited by Costa Rican cooperativism. The ideal scenario would be to return to the concept of Cooperative Society, something common in Latin American Comparative Law and which could more easily generate a differentiated recognition from the cooperative act, among the institutes of Civil and Commercial Law. The administrative structure of cooperatives must be modernized, and the rights and obligations of partners and forms of claim in court need to



be regulated more precisely. It is necessary to properly regulate the merger process and establish the possibilities for the transformation of cooperative societies.

The Regulation of Financial Intermediation Activity Law for Savings and Credit Unions also deserves to be revised, in order to prevent financial supervision models imposed by the banking superintendency from denaturing the cooperative purpose of the organizations.

It is important to reformulate the model of the self-managed cooperative, in order to enhance it as an alternative for ventures that arise from the new economic reality, self-management cooperatives cannot be instruments that compromise work activities.

In the area of cooperative integration it is necessary to examine the entire model of political representation of the Costa Rican cooperative movement, the convenience of the vertical integration that is born from the bases to the instance of the confederations which constitutes the public image of the cooperative movement, has been discussed in different forums.

## V. Conclusions.

In addition to the input from the responses of ICA member entities, the expert has consulted with well-known cooperative leaders and base associates, so the report drafted has a particular adherence with the latest views on cooperative legislation in Costa Rica.

Like in several Latin American countries, there has been discussion in Costa Rica about the relevance of taxing cooperatives, the issue should not be considered as resolved, legislators from new political generations do not have the same vision about the cooperative movement as their predecessors.

The dynamics of change that are being experienced in the country, must be exploited by the cooperative leadership, in order to have a positive impact on the parliament so that reforms to cooperative legislation are treated as priority.

San Jose, Costa Rica. July, 2019.

**Edgardo René Ramos Carmona.**