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AN ISSUE ON LEGAL PERSONALITY OF COOPERATIVES IN  
FRAMEWORK ACT ON COOPERATIVES IN SOUTH KOREA:  
ITS SIDE EFFECT AND DIRECTION FOR REVISION

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## ABSTRACT

This article explores an issue on legal personality of cooperatives under the Framework Act on Cooperatives (FAC) in the Republic of Korea. The FAC defines cooperatives as “legal entity” and social cooperatives as “non-profit corporation”. This division led to considerable confusion in Korea in terms of the co-operatives’ practices between profit-making ones and non-profit ones, and it is necessary to resolve this juridical segmentation. This article traces background of FAC which created this legal segmentation and suggests the unification of both co-operatives as “cooperative entity” with the aim of allowing them to be certified or registered as “social cooperatives” when they yield high social value.

**KEYWORDS:** Framework Act on Cooperatives, legal entity, cooperative entity.

**SUMMARY:** 1. *OUTLINE OF LEGAL REGULATIONS ON COOPERATIVES IN SOUTH KOREA.* 2. *LAW MAKERS ARGUMENTS ON LEGAL PERSONALITY OF COOPERATIVES IN THE FAC.* 3. *MISLEADING “LEGAL ENTITY” AS PROFIT-MAKING CORPORATION IN REALITY AND ITS SIDE EFFECT.* 3.1. *cooperatives called as “general cooperatives” and as “profit-making business” in tax system.* 3.2. *Passing over pro-public nature of cooperatives as a whole.* 4. *CONCLUSION: BEYOND DICHOTOMY- DIRECTION FOR REVISION OF THE FAC.* 5. *REFERENCES*

## 1 OUTLINE OF LEGAL REGULATIONS ON COOPERATIVES IN SOUTH KOREA

In accordance with the postwar of Korean War recovery and economic development by government lead, the Agricultural Cooperatives Act was firstly enacted in 1957, the Small and Medium Enterprise Cooperatives Act, the Fisheries Cooperatives Act, the Tobacco Production Cooperatives Act, and the Community Credit Cooperatives Act in enacted one by one as special acts related to cooperatives. On the other hand, the Credit Unions Act and the Consumer Cooperatives Act were enacted much after the dissemination of grassroot-cooperative movement, but they also were enacted as special acts. As a result, South Korea (hereafter Korea) has implemented legal regulations on cooperatives by revising each special acts whenever amendments are needed since 1957.

This situation was changed in 2012 because the Framework Act on Cooperatives (hereafter FAC) was enacted.<sup>1</sup> The FAC generally recognizes cooperatives as legal entity. People can establish cooperatives or social cooperatives under the FAC, alongside incorporate associations or foundations under the Civil Act, and companies of five forms (unlimited partnership, limited partnership, limited company, limited liability company, and stock company) under the Commercial Act.

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<sup>1</sup> The Korean Law Information Center website, Available at: [www.law.go.kr/engLsSc.do?menuId=1&subMenuId=21&tabMenuId=117&query=%ED%98%91%EB%8F%99%EC%A1%B0%ED%95%A9%20%EA%B8%B0%EB%B3%B8%EB%B2%95#](http://www.law.go.kr/engLsSc.do?menuId=1&subMenuId=21&tabMenuId=117&query=%ED%98%91%EB%8F%99%EC%A1%B0%ED%95%A9%20%EA%B8%B0%EB%B3%B8%EB%B2%95#), accessed in 24 July, 2021.

Table 1. Legal regulations on cooperatives in Korea

Title of act	Enactment date/Act No.	Regulation ministry or office
Agricultural Cooperatives Act	1957. 2. 14. /Act No.436.	Ministry of Agriculture, Food and Rural Affairs
Small and Medium Enterprise Cooperatives Act	1961. 12. 27/Act No.884	Ministry of SMEs and Startups
Fisheries Cooperatives Act	1962. 1. 20/Act No.1013.	Ministry of Oceans and Fisheries
Tobacco Production Cooperatives Act	1963. 5. 29/Act No.1347	Ministry of Economy and Finance
Credit Unions Act	1972. 8. 17/Act No.2338	Financial Services Commission
Forestry Cooperatives Act	1980.1.4/Act No.3231	Korea Forest Service
Community Credit Cooperatives Act	1980.12.31/Act No.3622	Ministry of Interior and Safety
Consumer Cooperatives Act	1999. 2. 5/Act No.5743	Korea Fair trade Commission
Framework Act on Cooperatives	2012.1.26/Act No.11211	Ministry of Economy and Finance

The FAC was enacted to facilitate independent, self-supportive, and autonomous activities of cooperatives, thereby contributing to social integration and balanced development of the national economy by providing for basic matters regarding the establishment and operation of cooperatives. (Article 1 of FAC)

The definition of cooperative under FAC means a business organization that intends to enhance its members' <sup>23</sup>rights and interests, thereby contributing to local communities by being engaged in the cooperative purchasing, production, sales, and provision of goods or services (1 Paragraph, Article 2 of FAC). It is characterized by specifying "business organization to contribute to local communities" defining a cooperative. Meanwhile, social cooperative is defined a cooperative that carries out business activities related to the enhancement of rights, interests, and welfare of local residents or provides social services or jobs to disadvantages people, among cooperatives under FAC, but that is not run profit (3 Paragraph, Article 2 of FAC). These definitions of cooperative and social cooperative seem to be more emphasizing cooperative's role in society rather than different type of enterprise.

Furthermore, in Article 6(Basic Principles), the FAC reflects co-operative principles of International Co-operative Alliance like this: each cooperative, federation of cooperatives, social cooperative, or federation of social cooperatives

<sup>2</sup> The Korean Law Information Center website translated members as "partners".

<sup>3</sup> The Korean Law Information Center website translated members as "partners".

shall be voluntarily organized, shall own property in common, and shall be operated democratically (2 Paragraph, Article 6 of FAC).

The minimum members of a cooperative should be five, and cooperatives may be established in all industry categories except financial and insurance industries. Since 1<sup>st</sup> December 2012 until March 2021, the 20,166 cooperatives have been established. Among them, social cooperatives are 2,794 (13.9%), federations of cooperatives are 106 (0.5%), and 17,266(85.6%) are registered as cooperatives. According to the government's 2018 survey, 58.7% of co-operatives have less than 10 members per cooperative, 2.6 % of co-operatives have more than 300, and the number of employees is 42,725.<sup>4</sup>

If we look at legal regulation on cooperatives globally, there are four legislative systems: 1) legislation on cooperatives under Civil Act or Commercial Act such as Italy and Belgium, 2) legislation as common law of cooperatives such as Portugal and Germany, 3) special act on cooperative-legislations according to industrial needs such as Japan, Romania, 4) coexistence of special acts and framework act on cooperatives such as France and Taiwan.<sup>5</sup> Before the enactment of the FAC in 2012, Korea corresponded to special act legislation in accordance with the country's industrial needs. Then, can we say that Korea's cooperative legal system has been changed to coexistence of special acts and framework act on cooperatives like since 2012?

Normally, it seems so, but it is different in reality. In France and Taiwan, both considered to coexistence of special acts and common law on cooperatives, the common laws function as the cooperative framework act by supplementing what each cooperative- special act cannot regulate, but in Korea, the FAC cannot be applied to cooperatives under one of the eight special acts on cooperatives in the Table 1. In other words, Korea still has a cooperative legal system in which special acts on cooperatives in spite of the FAC.

The FAC has three features as compared with the eight special acts as described in Table 2.

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<sup>4</sup> Press Release, *Report on 4<sup>th</sup> Survey on Cooperatives*, Seoul, Ministry of Economy and Finance, 2020/03/31.

<sup>5</sup> KIM. D., A Study on Overcoming Crisis of Cooperative Identity and Autonomy, *The Korean Journal of Cooperative Studies* VOL.31. No.1., Seoul, Korean Society for Cooperatives Studies, 2014.4, p.94.

Table 2. Differences of the FAC and eight special acts on cooperatives

	The FAC	8 special acts on cooperatives
Establishment	Register system (Approval in case of social cooperative)	Approval System
Industry sector	All industry sector except finance and insurance	Each special act per each sector
Legal personality	Legal entity	Non-profit corporation

This paper aims to explore issue on legal personality of cooperatives under the FAC. Why law makers identified cooperatives as “legal entity” unlike to special acts on eight cooperatives in which cooperatives are “nonprofit corporation”? The issue of legal personality of cooperatives under the FAC is critical because public procurement, charitable contribution deduction as well as tax system for cooperatives is different whether profit-making corporation or nonprofit corporation in Korea. The paper reviews argument on legal personality back to the time of enactment of the FAC, and exams how it works in reality, lastly suggests the direction of revision of the FAC on the issue.

## 2 LAW MAKERS ARGUMENTS ON LEGAL PERSONALITY OF COOPERATIVES IN THE FAC

This part deals with the question of whether the ILO has the power to set standards on cooperative law-making (1.), whether Paragraph 10. (1) of the ILO R. 193 establishes a legal obligation for national law-makers to translate the cooperative principles into legal rules (2.) and whether this obligation is effective (3.).

The FAC states that each cooperative or federation of cooperatives shall be a legal entity (FAC: Article 4(1)). But, social cooperative or federation of social cooperatives shall be a non-profit corporation in Article 4(2). These requirements have served as factor of determination for business conditions such as legal reserve, dividends and disposal of residual property, etc.); and for the public awareness of the cooperative identity.

There was no disagreement about the fact that the legal entity status of cooperatives was granted separately from the Civil Act and the Commercial Act in 2011 during the enactment of the FAC. However, there has been a fierce battle over what kind of legal personality was suitable to cooperatives. Firstly, the Democratic Party’s bill, which was the opposition party at that time, classified legal entity of cooperatives as limited liability companies under the Commercial Act. On the other hand, the legislative petition submitted by civil society including cooperative movement defined cooperatives and cooperative federations as non-profit corporations. This petition highlighted cooperatives differentiated

by having pro-public nature from for-profit corporations. Meanwhile, the ruling party's proposal at the time defined cooperatives and their federations as legal entity, but suggested to give separate legal personality to social cooperatives and their federations.

The limited liability company under the Commercial Act or incorporated associations under the Civil Act shall have many differences in the authority, duties, and status of members. Because an incorporated association has the characteristics of a human joining, one vote per person is granted, the status of the member cannot be transferred or inherited, and the members shall not claim his/her rights to the incorporated association. On the other hand, a limited liability company (LLC) has both characteristics as a human joining and capital joining in kind, so member is allowed to claim his/her shares in the entity, although exercise one vote per person, and may have residual claims. The three bills proposed at the time of enactment show that the understandings of cooperative legal personality were completely different, as arguments defining cooperatives as limited liability companies under the Commercial Act or as incorporated associations under the Civil Act.

Table 3. LLC vs. incorporated association

Items	LLC	Incorporated association
Legislation	Commercial Act (Part 3, Chapter3-2)	Civil Act (Part 1, Chapter 3)
Establishment	Register	Approval
Voting right	One vote one member	One vote one member
Member status	Inalienability without consent of other members	Inalienability
Member withdraw or dismiss	Business year base (notice 6 months before), Request to court	No articles
Residual claims	Have	Have not
Disposal of residual property	Distribution to members	Donation to non-profit organizations or National Treasury

Finally, the FAC was proposed as “legal entity” and social cooperatives and their federations as “non-profit corporation”. The difference is as shown in Table 4.

Table 4. the difference of cooperatives and social cooperatives under the FAC

Items	Cooperatives	Social cooperatives
Legal personality	Legal entity	Non-profit corporation
Establishment	Register to mayors and governors	Approval of ministry and chief of offices concerned
Business sector	All industry sector except finance and insurance	Carry out at least 40% public purpose business
Legal reserve	At least 10% of surplus every fiscal year, to reach three times of total amount of share capital	At least 30/100 of surplus every fiscal year, to reach three times of total amount of share capital
Allocation	Provision of dividend	No dividend

### 3 MISLEADING “LEGAL ENTITY” AS PROFIT-MAKING CORPORATION IN REALITY AND ITS SIDE EFFECT

#### 3.1. Cooperatives called as “general cooperatives” and as “profit-making business” in tax system

The FAC in Korea specifies “social cooperatives” as non-profit corporations (FAC: Article 4 (2)), and due to this regulation, cooperatives are interpreted as profit-making business under the Corporate Tax Act. And the latter is often referred to as the “general cooperatives”. Due to the dichotomy between cooperatives regarded as profit-making business like for-profit corporations and social cooperatives regarded as non-profit corporations like non-profit organizations, there is considerable confusion at the cooperative site. In policy implementation, cooperatives tend to be identified as having two “different types”: “general cooperatives” and “social cooperatives”, and the two sides often interpret them as different from the essence.

Regarding Legal consistency to interpret which cooperatives under the FAC are treated as “for-profit corporations” has incurred two big problems. The first problem is transaction between cooperatives and their federation is considered like as merchants’ business activities. Commercial Act shall apply *mutatis mutandis* to cooperatives except as otherwise provided for in the FAC (Article 14 (1)), this misleads an understanding that cooperatives are also shall be regarded as merchants like for-profit corporations under the Commercial Act. Since federation of cooperatives and its members’ transactions are based on mutuality, it is difficult to see them as up-front, and it is often inappropriate to apply “commercial law” to them.



Secondly, there has been a phenomenon in which only social cooperatives have hold the social values of cooperatives. Even a cooperative that employs the vulnerable or provides social services to the vulnerable, if it is not approved as social cooperative, it is treated as profit-making business in tax system as well as do not enjoy of benefit in public procurement and charitable contribution deduction. Even if the articles of association of a cooperative specify that residual prosperity shall not be attributed to members upon liquidation of residual property. Since “general cooperatives” are interpreted as “profit-making business,” opportunities for access to various benefits from municipals are greatly limited. In other words, even if a cooperative conducts cooperative identity in its activities in accordance with co-operative principles, it is placed in a very poor position compared to the “non-profit” social cooperative.

As the result, the FAC seems to do not pay attention to the common features like reciprocity and democracy due to the premise of a dichotomy between “general” cooperatives and social cooperatives. A cooperative is an organization established to meet the common needs and aspirations of its members. In order to determine whether such needs and aspirations are supported by public authority or should be interpreted as profit-making business without a difference from other for-profit entities, each cooperative’s specific business activities must be clarified first. Among one cooperative, businesses can be divided into member service and non-member service. And tax treatment may be different to the characteristics of business. However, under the FAC, dichotomous distinction of legal personality is blocking even such attempts.

### 3.2. Passing over pro-public nature of cooperatives as a whole

A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly- owned and democratically-controlled enterprise based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity<sup>6</sup>, regardless of their type or business contents. Also, the cooperative principles that have shared internationally for more than a hundred years support co-operative operation. Reflecting the co-operative principles, the FAC stipulates that each cooperative, federation of cooperatives, social cooperatives and federation of social cooperatives shall carry out its activities actively for providing educational and training programs to its members (FAC: Article 7).

Cooperatives have been realized a different way of democratic and collective ownership from their historical emergence to modern period, where the public benefit embedded in a way that helps community members lead a better life and not

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<sup>6</sup> <https://www.ica.coop/en/cooperatives/cooperative-identity>

just in their members' common interests. the International Co-operative Alliance (ICA) explains the principles of co-operatives derived from the historical practice of co-operatives.<sup>7</sup>

“Co-operatives promote the economic and social development of their members and the development of co-operatives and other socially responsible economic actors in the fabric of local economies. Many do so without aiming to make a financial profit, but aiming instead to develop and strengthen local economies for the benefit of their members and the wider community. The economic and social contribution of co-operatives to a local or regional economy is a social impact contribution benefitting the community and civil society. Co-operatives making such a contribution can be described as “managing common-wealth” to benefit the local community, its economy and society. Where this contribution is a dedicated objective and purpose of co-operatives, it is appropriate for it to be recognized by the public authorities by awarding them specific legal and tax treatment that recognize their wider contribution to tackling wealth inequality. This issue is worthy of discussion with national governments.”

From this point of view, the nature of cooperatives, especially in light of the fact that cooperatives shall comply with the ICA's 7th Principle: concern for community, can be regarded as having a certain public benefit, or pro-public.

Let's look at the examples of Korea's cooperatives conducted under the FAC. More than 70% of cooperatives under the FAC are business cooperatives composed of small merchants and self-employment. The establishment of cooperatives seems to have been used as a way to enhance competitiveness for small business owners who have been driven to excessive competition. Many self-employed or small business owners sought alternatives for efficiency and stabilization against large-capital franchises, and some cooperatives showed desired results.<sup>8</sup>

In addition, job creation for the vulnerable has its own public benefit in terms of contributing to social integration. According to the results of the 4th Survey on Cooperatives in 2019, 42.3% of all employees of cooperatives under the FAC are socially vulnerable.<sup>9</sup>

One of the public benefit of cooperatives is contribution to economic democratization. Such and freelance cooperatives instructors, interpreters and translators

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<sup>7</sup> ICA, *Guidance Notes to the Cooperative Principles*, Geneva, 2015, p.42.

<sup>8</sup> In Korea's retail market situation, where global competition is intensifying and the proportion of self-employed businesses is very high, small business owners have secured their competitiveness through cooperative with the banner of win-win cooperation. For the purpose of cost reduction, joint brand development, and provision of consumer benefits, seven business cooperatives united as Coopchise Federation in April 2019. The name of Coopchise means alternative franchise; cooperative franchise)

<sup>9</sup> Press Release, *Report on 4<sup>th</sup> Survey on Cooperatives*, Seoul, Ministry of Economy and Finance, 2020/03/31.

participated, platform cooperatives such as household workers and agents, and fair trade cooperatives under the FAC also are examples of that.

#### 4 CONCLUSION: BEYOND DICHOTOMY- DIRECTION FOR REVISION OF THE FAC

The FAC specifically defined only social cooperatives as non-profit corporations, but non-social cooperatives were considered as complementary set related to social cooperatives, so referred to as “general” cooperatives in the early days of the enactment of the FAC.<sup>10</sup> Subsequent work then should be embodied into a legal system that seeks to find out how companies under the Commercial Act, incorporated associations under the Civil Act, and cooperatives under the Framework Act on Cooperatives can “coexist”, not into dichotomous division. In the absence of progress in such follow-up work, cooperatives and social cooperatives under the Framework Act on Cooperatives were respectively considered as for-profit corporations under the Commercial Act and corporations under the Civil Act.

The criteria for distinguishing between for-profit corporations and non-profit corporations are similar in Korea and the U.S. in terms of following profit allocation prohibition as a standard that distinguishes for-profit corporation from non-profits.<sup>11</sup> However, in Korea, some cooperatives that are treated as non-profit corporations under special acts allow co-operatives to dividends and member allocation when dissolve.

Furthermore, among the special acts on cooperatives, there are notable cases like article 112 of the Agricultural Cooperatives Act and Article 113 of the Fisheries Cooperatives Act. These legal provisions stipulate Cooperative Joint Venture Corporations (Johab Gongdong Sa-eup Beo-bin) among member cooperative and federations, when they shall jointly invest and conduct projects, the voting rights shall be exercised in proportion to the amount of investment, but this shall not be treated as a profit-making corporation under the Agriculture Cooperative Act. Cooperative Joint Venture Corporations are also recognized as a kind of cooperative under the Agricultural Cooperatives Act and Fisheries Cooperatives Act. Many small and medium-sized enterprises are for-profit corporations registered as companies under the Commercial Act, but when they are allied as cooperative federation under the Small and Medium Enterprise Cooperatives Act, the Act requires that they “not-for profit” (Paragraph 7, Article 7). Even if the cooperative

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<sup>10</sup> KIM. G, Outcome and Task of Five years since enforcement of the FAC, COOPERATIVE NETWORK Vol.57, Seoul, Korea Cooperative Research, 2018.8, p. 175.

<sup>11</sup> YIM. JS. And CHO. SH., A Study on the Non-Profit and Public Interest as a Social Cooperatives, *Hongik Law Review* Vol.15 No. 4, Seoul , Hongik University, 2014. 12, p. 358

is a group of profit-making agents, the cooperative itself cannot be seen as commercial.

Co-operatives have substance neither for-profit corporations nor not-profit corporations. In order to the FAC work as a common law that faithfully supports cooperative identity, a legal and institutional design is required as a “cooperative entity” as a legal personality that recognizes cooperatives as an enterprise based on reciprocity, an “intermediate form of human joining and capital joining in kind.” To this end, it can be more systematic legislation to unify both social cooperatives and cooperatives into “cooperative entity” and to allow them to be certified or registered as “social cooperatives” when they have a highly generating public benefit business performance.

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