RESEARCH NOTE 4

International Comparison of Unfair Competition Theories

in the Non-Profit Sector

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1. Introduction

In modern Japan, public interest corporations and non-profit organizations (NPOs) are expected to play a crucial role in addressing increasingly diverse social issues, filling gaps that traditional government services cannot reach. However, when these organizations expand their business activities to secure independent financial resources necessary to sustain and grow their work, they constantly face criticism regarding "commercial squeeze" (crowding out private business) or "unfair competition with for-profit businesses". While the 2008 public interest corporation reform reorganized corporate governance and the evaluation framework for public benefit status, strong dissatisfaction remains among for-profit businesses, who argue that "it is unfair competition for tax-exempt organizations receiving tax preferences to engage in commercial activities within the same market" (Government Tax Commission, 2000).

In contrast, looking at Western countries reveals a different reality: even when non-profit organizations run large-scale revenue-generating businesses, theories of unfair competition rarely become major social issues in the way they do in Japan. For example, in the United Kingdom, based on a "purpose-driven approach", business activities directly linked to a charity's purpose are broadly permitted as "Primary Purpose Trading" (Charity Commission for England and Wales, 2023). In the United States, the tax system uses a balancing tool called the "Unrelated Business Income Tax (UBIT)" to curb unfair competition, aiming to level the playing field in the market (Brody, 2012).

Table 1 summarizes the basic principles of taxation in Japan, the United Kingdom, and the United States, as well as Canada, Australia, and New Zealand.

As is clear from this table, Japan's "activity-based approach (enumerated list system)" occupies a unique position compared to other countries. However, as discussed later, this enumerated list system was originally designed at the time of its introduction based on the exact same concept as the US UBIT and Canada's "related business" legal doctrine: "leveling the playing field between tax-privileged organizations and private commercial businesses"[1](Itsuki Sukegawa, 2016). Through a comparative analysis centered on six countries—Japan, the United Kingdom, the United States, Canada, Australia, and New Zealand—this paper clarifies the institutional and historical background behind why theories of "commercial squeeze" repeatedly escalate in Japan.

Table 1: International Comparison of Taxation Principles

Country / Region	Basic Principle	Tax Logic and Operational Reality
Japan	Activity-Based Approach (Enumerated List System)	If an activity falls under any of the 34 revenue-generating businesses specifically itemized by cabinet order (Article 5 of the Order for Enforcement of the Corporate Tax Act), it is uniformly taxed regardless of the purpose of the activity or how profits are used.

[1] History of Japan's 34 Revenue-Generating Businesses: The current 34 categories of revenue-generating businesses include retail sales, real estate sales, money lending, and others (Article 5, Paragraph 1 of the Order for Enforcement of the Corporate Tax Act). At the time of its introduction in 1950 (Showa 25), the system directly adopted 29 business categories that had been subject to the former business tax (abolished in 1947 / Showa 22). Since then, through several revisions matching changes in the economic activities of private commercial enterprises, the list was expanded to 34 business categories (Itsuki Sukegawa, 2016).

Country / Region	Basic Principle	Tax Logic and Operational Reality
United Kingdom	Purpose-Based Approach	Business activities that directly fulfill a charity's purpose (Primary Purpose Trading) are tax-exempt in principle. Activities not directly linked to the purpose are taxed, or must be spun off and run through a commercial subsidiary (Trading Subsidiary).
New Zealand	Purpose-Based Approach	Income generated from business activities run by a registered charity exclusively for charitable purposes is tax-exempt under Section CW42 of the Income Tax Act 2007.
United States	Substantial Relation Approach	Business activities that are "substantially related" to achieving the tax-exempt purpose are non-taxable. Unrelated business activities are subject to the Unrelated Business Income Tax (UBIT) at standard corporate tax rates.
Canada	Substantial Relation Approach	Uses the legal doctrine of "related business," exempting activities that directly contribute to achieving the purpose or businesses operated substantially by volunteers.
Australia	Comprehensive Tax Exemption Approach	Charities registered with the ACNC and endorsed by the ATO receive a tax exemption on the organization's entire income, regardless of whether business activities are related to their core purpose.

2. Structure of the "Unfair Competition Theory" in Japan

2.1 Limitations of the "Activity-Based Approach" in the Corporate Tax Act

One factor causing the "unfair competition theory" to be constantly reproduced in Japan's non-profit sector lies in the "activity-based approach (enumerated list system)" taxation system adopted by the current Corporate Tax Act. Japan's Corporate Tax Act delegates the definition of revenue-generating businesses to cabinet orders. Article 5 of the Order for Enforcement of the Corporate Tax Act levies corporate tax on activities that fall under any of the 34 specifically itemized businesses ("34 specifically listed business types")—such as retail sales, real estate sales, and money lending—provided they are operated continuously at a fixed place of business (Kaneko, 2021; Nakazato et al., 2021).

The defining feature of this system is that taxability is determined purely by whether external "activities" match the list, regardless of the "purpose (mission)" or "use" of how revenues generated from the business are ultimately applied to public benefit objectives. However, this enumerated list system was historically not unrelated to the concept of competitive fairness. At its introduction in 1950, the target categories were established by adopting 29 business types subject to the former business tax (abolished the previous year), with an explicit intent to "balance taxation by listing businesses that compete with private commercial enterprises" (Itsuki Sukegawa, 2016). Therefore, the problem with Japan's system is not the absence of the concept of competitive fairness itself, but rather that subsequent enforcement froze into a static standard—formal eligibility under an itemized list of business types—instead of dynamic standards that question the essential nature of the business and its connection to public benefit goals (such as the purpose-based or relation-based approaches in the UK, US, Canada, Australia, and New Zealand).

2.2 Government-Led View of Public Interest and Commercial Squeeze Arguments

In addition to this legal framework, Japan's unique historical and cultural "view of public interest" also sharpens theories of unfair competition. Since the enactment of the former Civil Code during the Meiji era, a strong understanding has long persisted in Japan that "public interest is something carried out by the government (administration)" (Yamauchi, 1997). Due to this historical background, social understanding of private entities independently taking on public benefit roles and providing value through the market is not necessarily widely shared.

As a result, when non-profit organizations enter the market through revenue-generating activities, it easily sparks backlash from for-profit businesses arguing that "it is unfair for organizations receiving preferences like tax exemptions or subsidies to operate in the same market". Such criticisms tend to focus solely on differences in market competition conditions, rather than on the inherent significance of non-profit business activities in "remedying market failures" or "solving social challenges" (Yamauchi, 1997).

3. "Purpose-Based Approach" and Business Justification in the United Kingdom

3.1 Legal Doctrine of "Primary Purpose Trading"

In UK charity law, the primary justification for business activities rests on a "purpose-based approach". In the UK, business activities directly conducted by a charity to fulfill its established purpose (charitable purpose) are called "Primary Purpose Trading". Revenues generated from these activities are, in principle, tax-exempt—no matter how commercial they appear on the outside[2] (Charity Commission for England and Wales, 2023). While Japan's "activity-based approach" focuses on the category of "what is being sold", the UK's "purpose-based approach" places importance on the context of "why the business is being conducted" (Luxton, 2001).

3.2 Avoiding Theories of Unfair Competition and Social Consensus

One reason theories of unfair competition rarely become severe in the UK is the social and institutional trust placed in this "alignment of purpose". Social consensus surrounding a charity conducting business is based on the understanding that "as long as it contributes to achieving charitable purposes, using business activities as a tool is a reasonable approach" (Shiraishi, 2024). Furthermore, the Charity Commission holds the authority to oversee the purpose-alignment of business activities, and this oversight function helps guarantee the quality of public benefit status to a certain degree.

3.3 Risk Isolation and Ensuring Fairness Through Commercial Subsidiaries

On the other hand, for business activities not directly related to charitable purposes (Non-primary purpose trading), it is common practice in the UK to establish a "Trading Subsidiary" to carry them out (Charity Commission for England and Wales, 2023). This separation model serves two key functions: first, protecting the core charity's assets from commercial risks; second, leveling the playing field with commercial enterprises by subjecting non-primary purpose businesses to standard corporate tax.

Profits generated by the subsidiary are effectively tax-exempt when returned to the parent charity through a donation mechanism[3], and this clear separation serves as a mechanism to curb feelings of unfairness among commercial businesses (Japan Association of Charitable Organizations, 2020).

4. "UBIT" and the Substantial Relation Approach in the United States

4.1 Background of the Introduction of the UBIT System

Public charities and private foundations operating under Section 501(c)(3) of the US Internal Revenue Code are legally presumed to conduct business activities that contribute to achieving their tax-exempt purposes, and generating revenue through these activities is recognized under the system. Under the US legal framework, non-profit organizations generating independent revenue or conducting business activities aligned with their mission is broadly viewed in a positive light in principle; simply offering services or products for a fee does not invalidate tax-exempt status.

However, while guaranteeing this freedom of business activity, an essential mechanism to keep non-profit business expansion within an appropriate framework is the "Unrelated Business Income Tax (UBIT)", introduced by the

[2] Examples of Primary Purpose Trading: Typical examples falling under "Primary Purpose Trading" include the sale of textbooks by an education-focused charity, or the manufacturing and sale of goods as part of training by a rehabilitation-focused charity (Charity Commission for England and Wales, 2023).

[3] Mechanism for Returning Subsidiary Profits: Strictly speaking, under UK tax law, "Gift Aid" refers to a mechanism applied to individual donations. The return of profits from a commercial subsidiary to a parent charity is governed as a "qualifying charitable donation" under Section 201 and following sections of the Corporation Tax Act 2010. In practical terms, this is also widely referred to colloquially as "Gift Aid."

Revenue Act of 1950. One major trigger for its introduction was a 1947 case where a donor group donated the stock of a pasta manufacturing company (C.F. Mueller Company) to the New York University (NYU) School of Law, which held and operated the company as a tax-exempt subsidiary. This arrangement drew criticism from competing commercial enterprises and Congress, who argued that "it represents an unfair competitive advantage using tax-exempt privileges". In response, the US Congress constructed a framework to correct competitive distortions arising when tax-exempt organizations conduct business unrelated to their core purpose (unrelated business) (Fishman et al., 2021).

4.2 Acceptance of Market Competition Centered on "Substantial Relation"

The core of the UBIT system lies in whether the business activity is **"substantially related"** to achieving the organization's tax-exempt purpose[4]. If the business content directly contributes to fulfilling the organization's mission, its tax-exempt status is maintained regardless of its scale or commercial nature (Hopkins, 2023). Specific examples include medical services at non-profit hospitals, university tuition, and art museum admission fees. In the US, it is fully permitted for these "related businesses" to compete directly with commercial enterprises in the market (Brody, 2012).

4.3 Institutional Absorption of Unfair Competition Theories

One reason why the topic of "commercial squeeze" rarely becomes as severe in the US as it does in Japan is that UBIT acts as a leveling device for competitive conditions (Brody, 2012). For business activities unrelated to core purposes, the standard corporate tax rate applied to regular commercial businesses is imposed. Because the rule that "tax businesses unrelated to purpose at the same rate as commercial companies" exists, criticism from commercial businesses regarding unfairness is processed and absorbed to a certain degree within the system. However, it should be noted that continuous debate remains within the US regarding the scope of UBIT application and standards for determining "substantial relation", meaning competitive issues are not completely eliminated.

5. Legal Doctrine of "Related Business" and Implicit Competitive Adjustments in Canada

5.1 Implicit Discipline Independent of Statutory Law

Section 149.1 of Canada's Income Tax Act permits registered charities and public foundations to carry on a "related business", while prohibiting private foundations from conducting any business activities regardless of whether they are related or unrelated (Income Tax Act, R.S.C. 1985, c.1 (5th Supp.), s.149.1). The statute does not actively define the content of a "related business"; instead, specific criteria for determination are left to Canada Revenue Agency (CRA) Policy Statement CPS-019, "What is a Related Business?" (2003) (Canada Revenue Agency, 2003). According to this guidance, a related business must qualify as either (1) a business linked to and subordinate to the charity's purpose, or (2) a business run substantially by volunteers (Canada Revenue Agency, 2003).

What deserves attention here is the structure of Canada's system, which combines rigid and flexible elements. In Canada, unlike the US, there is no framework (such as UBIT) that allows an organization to directly run an "unrelated business" and pay tax on it; directly conducting an unrelated business is uniformly prohibited. On the flip side, however, through CRA guidance, the concept of a "related business" is interpreted flexibly and broadly, creating an operational balance that accommodates the practical revenue needs of non-profit organizations.

A unique historical background led to this system design. During tax reform discussions in the 1960s, the Canadian government examined the US experience with the Unrelated Business Income Tax (UBIT) and deliberately chose an approach of leaving the specific boundaries to CRA administrative interpretation rather than codifying the meaning of "related business activities" into statutory law (Carters Professional Corporation, 2008). This can be described as

[4]Three-Prong Test for UBIT Liability: Under US case law, to be subject to UBIT, an activity must satisfy all three of the following requirements: (1) the activity constitutes a "trade or business," (2) the activity is "regularly carried on," and (3) the activity is "not substantially related" to achieving the tax-exempt purpose (United States v. American Bar Endowment, 477 U.S. 105 (1986); Hopkins, 2023).

a guidance-dependent approach, distinct from both the UK (which solidified purpose-alignment frameworks through case law and administrative guidance) and the US (which explicitly created a tax-balancing valve like UBIT in statutory law).

5.2 Graduated Sanctions and Risk Isolation Structure

If a registered charity conducts an unrelated business, the CRA imposes graduated sanctions. A clear ladder of administrative sanctions exists: a penalty equal to 5% of gross revenue generated from the business for a first offense, a penalty equal to 100% of gross revenue plus suspension of tax-receipt-issuing privileges for a repeat offense within 5 years, and revocation of registered charity status for severe cases. This structured administrative enforcement ladder is a unique Canadian feature not seen in Japan, the UK, or the US (Charity Law Group, n.d.). On the other hand, similar to the UK's Trading Subsidiary framework, the practice of separating non-primary purpose businesses into separate legal entities and returning post-tax profits as donations to the parent charity is broadly established, serving both to isolate commercial risks and level competitive conditions (Charity Law Group, n.d.).

5.3 Low Prominence of Unfair Competition Theories

In Canada, cases where theories of "commercial squeeze" escalate into major social issues like in Japan are virtually nonexistent. In the background, while adopting dynamic standards of "relation and subordination", CRA administrative guidance continuously clarifies interpretations, and the practice of isolating risks through trading subsidiaries has deeply taken root. Consequently, feelings of unfairness among commercial businesses are absorbed and resolved at the level of system implementation (Brouard, n.d.).

6. Comprehensive Tax Exemption Approach and Competitive Neutrality in Australia

6.1 Comprehensive Tax Exemption via ACNC and ATO

In Australia, registering as a charity with the Australian Charities and Not-for-profits Commission (ACNC)—a non-profit regulator established in 2012—is a prerequisite for receiving tax preferences. Systematically, an integrated registration method (one-stop application) is in place where applying for charity status through the ACNC automatically links with applying for tax preferences to the Australian Taxation Office (ATO). Through this mechanism, once an organization is certified by the ACNC and receives an endorsement (approval/certification) from the ATO, tax exemptions are applied. Once endorsed, the organization's overall income is uniformly tax-exempt, regardless of whether individual business activities are directly related to its core purpose (ATO, 2026). This represents a distinct feature: adopting a "comprehensive exemption" at the organization level, unlike the systems in the UK, US, and Canada that individually evaluate purpose-alignment or relation for each business activity.

6.2 Policy Debates over Competitive Neutrality and the Collapse of UBIT Implementation

However, competitive conditions between charitable commercial activities and commercial businesses have also been a repeated topic of policy debate in Australia. The 1995 Industry Commission report, Charitable Organisations in Australia, served as an opportunity to broadly examine how non-profit business activities should operate (Industry Commission, 1995). Furthermore, following the Henry Tax Review around 2010[5], the Gillard government proposed in its 2011–2012 budget the introduction of a US-style UBIT (Better Targeting for Not-for-Profit Tax Concessions) that would tax only unrelated business income (McGregor-Lowndes, Turnour, and Turnour, 2011). However, following strong pushback from the non-profit sector, implementation was postponed, and it was ultimately withdrawn under the subsequent Abbott government (McGregor-Lowndes, Turnour, and Turnour, 2011).

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[5] A comprehensive tax reform review (Australia's Future Tax System Review) launched under Treasury Secretary Ken Henry by the Rudd Labor government in 2008, which published its final report (containing 138 recommendations) in 2010. It served as a catalyst for reviewing tax preferences and considering Unrelated Business Income Tax (UBIT) in the non-profit sector.

6.3 Preservation of the Comprehensive Tax Exemption Approach and Its Implications

In the background of setting aside the UBIT introduction was the administrative simplicity brought by organization-level comprehensive tax exemptions, as well as the assessment that because many charities are small-scale, the tax revenue effect of introducing UBIT would be limited (McGregor-Lowndes, Turnour, and Turnour, 2011). On the other hand, regarding the Goods and Services Tax (GST)—equivalent to consumption tax—standard taxation applies in principle to commercial supplies made by charities, providing a mechanism that partially complements the lack of competitive neutrality at the income tax level.

7. "Exclusive Use" Requirement in New Zealand and Recent Emergence of Unfair Competition Theories

7.1 Framework of Section CW42 of the Income Tax Act

In New Zealand, income generated from businesses run by charities registered under the Charities Act 2005 is exempt from tax under Section CW42 of the Income Tax Act 2007, provided that the charity carries out its charitable purposes within New Zealand (Income Tax Act 2007, s CW42). As a requirement for tax exemption, a "control restriction" is imposed, ensuring that persons who substantially control the business cannot divert amounts generated from the business for private benefit outside of charitable purposes; if this rule is violated, the entire income generated from the business becomes subject to taxation (Parry Field Lawyers, 2024).

7.2 Emergence of Unfair Competition Theories as Seen in the Sanitarium Case

Like the UK, US, and Canada, New Zealand adopts a purpose-driven tax-exemption principle. Interestingly, however, among the countries surveyed in this paper, New Zealand is one of the rare exceptional cases where social criticism similar to Japan's "commercial squeeze" arguments has recently emerged.

Sanitarium Health & Wellbeing—operated under the Seventh-day Adventist Church—holds approximately 35% of the domestic cereal market through the manufacture and sale of breakfast cereals like "Weet-Bix", surpassing its publicly listed competitor Kellogg's (about 23%), yet it pays no corporate tax due to its charitable status (NZ Herald, 2024). Criticisms from competing businesses arguing that this tax exemption confers an unfair competitive advantage have been repeatedly raised through parliamentary submissions and other materials since the early 2000s (NZ Herald, 2024).

In 2025, Minister of Finance Nicola Willis proposed reviewing the scope of charity taxation, and annual reporting from Charities Services revealed that approximately 2 billion NZD in "profit" across the non-profit sector remained untaxed (RNZ, 2025). In these review discussions, systems from other countries—such as the UK model excluding non-primary purpose commercial activities from tax exemption, or the US-style UBIT taxing unrelated business income—have been referenced as comparative models (RNZ, 2025).

7.3 Institutional Implications

The New Zealand case offers rich insights by showing that even in a country adopting the dynamic standard of a purpose-based approach, theories of unfair competition can intensify depending on how tax-exemption requirements (such as the interpretation of "exclusively" or the effectiveness of control restrictions) are enforced and the level of financial disclosure. This provides a crucial perspective for this paper's comparative analysis: rather than the legal "model" itself (whether an activity-based or purpose-based approach), it is the reality of enforcement and information disclosure that can dictate the direction of unfair competition debates.

8. Conclusion

8.1 Differences in Evaluation Standards

Comparing these six countries—Japan, the United Kingdom, the United States, Canada, Australia, and New Zealand—highlights fundamental differences in how non-profit "business activities" are understood. The UK and US rely on a "purpose-based approach" or a "relation-based approach", placing the primary axis of evaluation on the context of the business (why it is conducted and how it serves the purpose) rather than its external appearance (what is being sold).

Canada and New Zealand, to varying degrees, adopt similar evaluation frameworks centered on purpose or relation. Australia goes even further with a more thorough system that comprehensively exempts the overall income of an endorsed charity. However, as shown by New Zealand's Sanitarium case discussed earlier, it is important to note that even under a purpose-based approach, theories of unfair competition can still intensify depending on how tax-exemption requirements are enforced and how financial information is disclosed.

In contrast, Japan determines taxability based on external standards—namely, whether an activity falls under the "34 revenue-generating business categories" in the Corporate Tax Act. For public interest corporations that have received public interest authorization, a framework called "tax exemption for public benefit business activities" exists, which renders these 34 business categories tax-exempt within the authorized scope.

However, this applies strictly to authorized public interest corporations and does not extend to unauthorized general incorporated associations or foundations. Furthermore, practical challenges remain significant: the process to obtain public interest authorization itself is extremely cumbersome, and the hurdle to have a revenue-generating business recognized as a "public benefit business" is exceptionally high.

8.2 Implications for System Design

The core takeaway from this comparative analysis is that Japan's "activity-based approach" was not inherently unrelated to the philosophy of competitive fairness; rather, at the time of its establishment in 1950, it was created precisely to embody that concept.

> The focus of today's unfair competition debate should be sought in the design differences between dynamic mechanisms that continuously evaluate a business's "contribution to purpose" (such as Primary Purpose Trading in the UK, UBIT in the US, and the related business doctrine in Canada) and a static mechanism that evaluates formal eligibility against a predetermined list of business types. Evaluating the merits of these different approaches lies beyond the scope of this paper. However, as a final conclusion, it should be pointed out that simply framing Japan's system as "an unusual system lacking the concept of competitive fairness" is historically inaccurate when viewed in light of its origins.

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