# Strengthening work incentives for second earners in Japan

## *Supplementary material*

The supplementary material provides: (i) detailed policy rules on spousal tax allowances under Japan's national and local income tax systems; (ii) an in-depth analysis of PTRs and METRs for the spousal allowance reform individually; (iii) detailed policy rules on net childcare costs and the Early Childhood Education and Care fee schedule for children under 3; and (iv) an in-depth analysis of PTRs and METRs for the childcare fee reform individually.

### *1. Overview of the tax allowances for low-income spouses in Japan*

Japan has an individual income tax system with some joint elements, offering additional allowances for taxpayers with a low-income spouse.

At **federal level** there are two deductions:

- ***Allowance for spouse*:** a tax allowance up to JPY 380 000 is given to a resident taxpayer whose reference income does not exceed JPY 10 000 000 and who lives with a spouse whose reference income does not exceed JPY 580 000.
- ***Special allowance for spouse:*** a tax allowance up to the amount shown in the following table is given to a resident taxpayer whose reference income does not exceed JPY 10 000 000 and who lives with a spouse whose reference income exceeds JPY 580 000 but does not exceed JPY 1 330 000.

| Spouse's income | Amount |
|---|---|
| 0-580,000 | 0 |
| 580,001-950,000 | 380,000 |
| 950,001-1,000,000 | 360,000 |
| 1,000,001-1,050,000 | 310,000 |
| 1,050,001-1,100,000 | 260,000 |
| 1,100,001-1,150,000 | 210,000 |
| 1,150,001-1,200,000 | 160,000 |
| 1,200,001-1,250,000 | 110,000 |
| 1,250,001-1,300,000 | 60,000 |
| 1,300,001-1,330,000 | 30,000 |
| 1,330,001 or more | 0 |

At **local level** there are two deductions that follow a similar structure but with **slightly lower deduction amounts**.

- ***Allowance for spouse*:** JPY 330 000 for resident taxpayers whose reference income does not exceed JPY 10 000 000 and who live with a spouse whose reference income does not exceed JPY 580 000.
- ***Special allowance for spouse:*** the allowance up to the amount shown in the following table is given to a resident taxpayer whose reference income does not exceed JPY 10 000 000 and who lives with a spouse whose reference income exceeds JPY 580 000 but does not exceed JPY 1 330 000.

| Spouse's income | Amount |
|---|---|
| 0-580,000 | 0 |
| 580,001-1,000,000 | 330,000 |
| 1,000,001-1,050,000 | 310,000 |
| 1,050,001-1,100,000 | 260,000 |
| 1,100,001-1,150,000 | 210,000 |
| 1,150,001-1,200,000 | 160,000 |
| 1,200,001-1,250,000 | 110,000 |
| 1,250,001-1,300,000 | 60,000 |
| 1,300,001-1,330,000 | 30,000 |
| 1,330,001 or more | 0 |

For both the Allowance and Special Allowance at local and national level the deduction decreases gradually when the **taxpayer's reference income** exceeds JPY **9,000,000**:

- Reference income not more than JPY 9 000 000: full amount;
- Reference income from JPY 9 000 001 to JPY 9 500 000: full amount*2/3;
- Reference income from JPY 9 500 001 to JPY 10 000 000: full amount*1/3
- Reference income above JPY 10 000 000: no allowance.

Source: OECD Tax-Benefit Model. Policy rules refer to January 1st, 2025.
The reference municipality of the OECD tax-benefit model for Japan is Tokyo.

### *2. Implications of removing tax allowances on work incentives for secondary earners.*

*Removing tax allowances for low-income spouses would strengthen work incentives for low-wage secondary earners.*

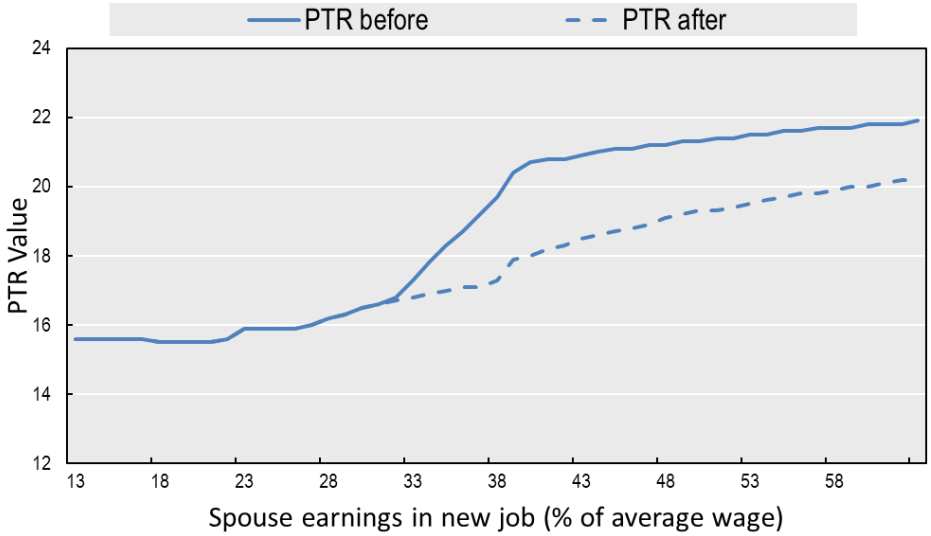
After the tax allowances removal, secondary earners would face smaller disincentives to take up employment, supporting stronger labour supply responses. Figure 1 compares participation tax rates (PTRs) for secondary earners entering full-time employment at a specific earnings level with the allowances in place, and after their removal. Participation tax rates measure the fraction of gross earnings that a family loses to higher taxes and/or lower benefits when a family member takes up employment.

At very low-income levels for the secondary earner, PTRs are the same under both scenarios, as the amount of the allowance remains unchanged when the spouse earns little compared to being out of work. This occurs because non-income-related provisions, like flat rate tax deductions, apply equally whether the individual is unemployed or earning a very low wage, leaving the marginal return to work unaffected.

As the second earner's income increases, the allowances start to phase out in the pre-reform scenario, at around 29% of the average wage. This reduces the net financial gain when the second earner enters (part time) employment, thus increasing PTRs in this earnings range (continuous line). The gap between the two curves shows this effect clearly.

## Figure 1. Removing tax allowances for low-income spouses would increase work incentives for secondary earners.

Participation tax rates for secondary earners




Note: Participation tax rate for a secondary earner, by earnings in the new job. The earnings of the primary earner are fixed at 67% of the average wage. The primary out of work benefit is social assistance. Housing benefit top-ups or temporary into-work benefits are not included. Policy reference data: 1 January, 2025.
Source: OECD Tax-Benefit Model version 2.8.0.

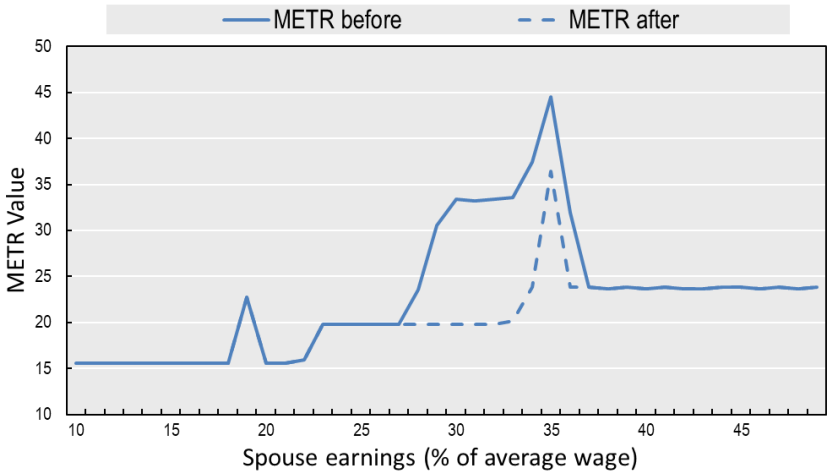
### *Fluctuations in secondary earners' incentives to increase working hours or earnings would also be reduced.*

The removal of the tax allowances would also smoothen and stabilise incentives for secondary earners to increase their wages across earnings levels. Figure 2 presents marginal effective tax rates (METRs) for secondary earners before and after the removal of the spousal allowances. METRs measure the fraction of gross earnings that a family loses to higher taxes and/or lower benefits when a family increases their wages or working hours once already in employment.

In the pre-reform system (solid line), METRs remain flat at low-income levels because the spousal allowance amount is fixed - households receive the full allowance regardless of additional earnings. This pattern is the same in the post-reform scenario, as the allowance only begins to affect work incentives to increase working hours once it starts to be withdrawn. When secondary earners' wages increase, the spousal allowances begin to be reduced. Each reduction in the allowance effectively raises the tax burden on the next increment of income. Without the stepwise withdrawal of the allowances (dashed line), secondary earners would face lower marginal effective tax rates, particularly at the earnings levels where the allowances would originally have been tapered, strengthening incentives to raise their earnings.

## Figure 2. Tapered spousal allowances cause fluctuations in secondary earners' incentives to increase work.

Marginal effective tax rates for secondary earners




Note: The figure shows the marginal effective tax rate (METR) for a secondary earner, by earnings in the new job. The gross earnings of the primary earner are fixed at 67% of the average wage. Policy reference data: January 1st, 2025.
Source: OECD Tax-Benefit Model version 2.8.0.

### *3. Overview of the net costs of Early Childhood Education and Care*

Childcare in Japan is jointly funded by families and public authorities. The national government estimates the total (gross) childcare cost, then sets the maximum parental contribution. The public subsidy covers the gap between the gross total cost and the effective costs paid by parents after applying relevant discounts that depend on children's age, parental income and family size.

**Step 1: Determine Effective Childcare Costs:**

The upper limit of monthly costs paid by parents depends on the age of children. Children **aged 3–5** attending eligible centres under the Free Early Childhood Education and Care (F-ECEC) programme pay no childcare fees. Parents only pay for meals, transportation, and materials. TaxBEN uses an average daily cost for both staple and non-staple foods of JPY 375 (out of which non-staple foods account for JYP 150).

For children **younger than 3** the upper limits of monthly costs increase with earnings-related residence tax paid by both parents. The amount of the earnings-related residence income tax is equal to the overall local income tax less the standard fixed per-capita amount of Prefectural and Municipal inhabitant taxes.

| | For children younger than 3 years old | |
|---|---|---|
| | for full-time workers | for part-time workers |
| Family on public social assistance (Section 3.1) or exempted from local tax payments (Section 8.2) | 0 yen | 0 yen |
| Earnings-related residence tax positive but lower than JPY 48600 | 19500 yen | 19300 yen |
| Earnings-related residence tax between JPY 48,601 and 57,700 | 30000 yen | 29600 yen |
| Earnings-related residence tax between JPY 57,701 and 97,000 | 30000 yen | 29600 yen |
| Earnings-related residence tax between JPY 97,001 and 169,000 | 44500 yen | 43900 yen |

| | | |
|---|---|---|
| Earnings-related residence tax between JPY 169,001 and 301,000 | 61000 yen | 60100 yen |
| Earnings-related residence tax between JPY 301,001 and 397,000 | 80000 yen | 78800 yen |
| Earnings-related residence tax above JPY 397,000 | 104000 yen | 102400 yen |

**Step 2: Apply Discounts for Family Circumstances**

After determining the upper limit of monthly costs, municipalities apply additional discounts for specific family characteristics:

| **Family Type** | **Discount for children under 3** |
|---|---|
| Lone parent with residence tax ≤ JPY 57,700 | 1 child: JPY9,000/month; additional child: free |
| Two-parent family with residence tax ≤ JPY 57,700 | 2nd child: half fee; 3rd+ child: free |
| Multiple children in childcare | 2nd child: half fee; 3rd+ child: free |
| Families on social assistance or with local tax exemptions | Free childcare (only pay for staple food) |
| **Family Type** | **Discount for children over 3** |
| reference annual income ≤ JPY 3 600 000 or families with 3+ children (under age of 9) independent of income | Only staple food cost |

**Step 3: Public Subsidy Calculation:**

The public subsidy is calculated by taking the difference between the nationally set gross childcare fees representing the total estimated cost of childcare and the parent's contribution after applying income brackets and relevant family discounts (effective childcare costs).

Subsidy = Gross Childcare Fees − Effective Childcare Cost (after discounts)

Figure 3 shows the calculation of the subsidy for one child, aged 2 years old is shown in the graph below:

## Figure 3. Childcare subsidies decrease stepwise with income for 1–2-year-olds.

Childcare fees and benefits, one child aged 2 years old

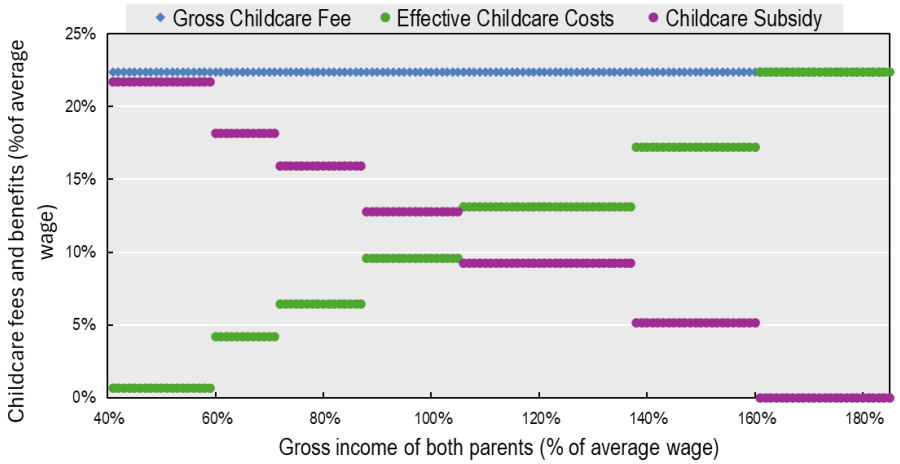



Figure Note: Childcare costs are calculated for families with 1 child (aged 2 years old) by gross income of both parents. The Gross Childcare Fee corresponds to the nationally set gross cost of childcare, and the effective childcare cost corresponds to the

parent's contribution. The income of one parent is set at 20% of the average wage, while the income of the other parent varies between 21-160% of the average wage. Both parents are assumed to work full time. In practice, an income of 20% of the average wage corresponds to working part-time at the minimum wage. This income was chosen for illustrative purposes to maximize the joint income range displayed in the Figure and illustrate the stepwise increases in parental contributions for childcare costs for parents with children aged 1-2 years old. Eligibility to social assistance is assumed. Policy reference data: January 1st, 2025. Source: OECD Tax-Benefit Model version 2.8.0.

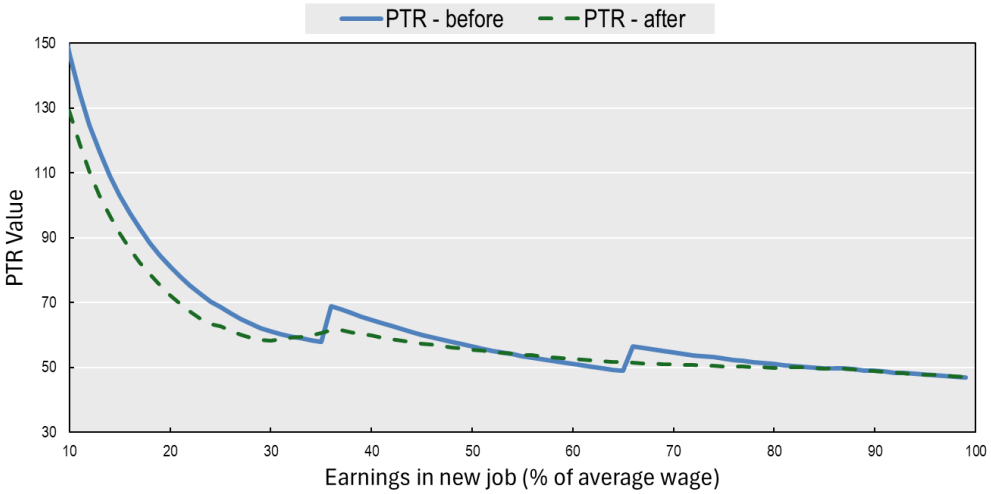
### 4. *Implications of linearising the childcare fee schedule on work incentives for secondary earners.*

*Work incentives for secondary earners would become more predictable.*

A linearised fee schedule would remove fluctuations in work incentives for secondary earners (Figure 4).

**Figure 4. Linear childcare fees would smoothen participation tax rates for secondary earners.**

Participation Tax Rates for secondary earners




Note: Calculations refer to a one child (aged 2) couple family with the principal earning the average wage. The second parent takes up full-time employment at the earnings level shown. It is assumed that no childcare is used when the second parent is out of work, and childcare services are used full-time when they take up employment. It is assumed that the household is eligible to social assistance. Housing benefits are not included. Policy reference data: January 1st, 2025. Source: OECD Tax-Benefit Model version 2.8.0.

Under the pre-reform system, the stepwise increase in fees leads to spikes in the percentage of earnings lost to lower benefits and higher taxes when the secondary earner takes up employment at a level that crosses an income threshold. At these income levels, a large portion of the secondary earner's wage would be offset by higher childcare fees, weakening the financial incentive to take up employment. Under the proposed reform, moving into employment at different wage levels would result in a more predictable net return, reducing the risk that families face sudden childcare benefit losses at these income thresholds. Under the reform, a lower withdrawal slope extends partial childcare support to higher income levels. As a result, secondary earners would face lower net childcare costs and consequently higher incentives to take up work across the earnings range illustrated, relative to the pre-reform scenario.

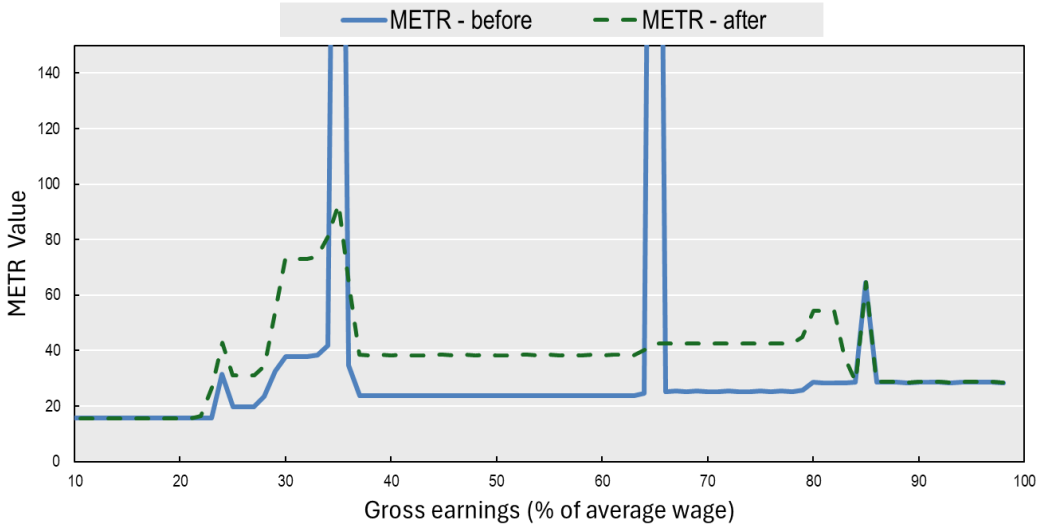
*While incentive continuity would be improved for low- and middle-income secondary earners, the financial return to additional work at higher earnings levels would dampen.*

A linear fee schedule would also improve the continuity of work incentives for secondary earners with a two-year old child (Figure 5). Under the pre-reform system, the stepwise design of childcare fees creates sharp spikes in work disincentives to increase earnings whenever joint parental earnings cross a fee threshold. At these points, a sudden increase in childcare costs absorbs a large share of any additional earnings, sharply reducing the financial return to work of an incremental wage increase. These spikes would be mitigated under the proposed reform, without the step-wise fee increases at these earning thresholds. At lower earnings levels, however, METRs would increase under the reform. This reflects the fact that *childcare support would be linearly decreasing with income rather than remaining flat between income thresholds. This implies a higher marginal loss from each incremental wage increase. Addressing these higher METRs at the bottom of the distribution while lowering net childcare costs would require a different type of reform, namely a childcare benefit that increases (rather than decreases) with earnings for families with childcare costs.*

Under the reform, the adjusted childcare fee schedule would extend childcare support further up the income distribution by tapering subsidies more gradually. While this provides higher overall support for middle-income families, it introduces a gradual phase-out in income brackets where support was previously constant (at its lowest level). For secondary earners in this range, each additional unit of income now triggers a marginal reduction in childcare subsidies. Consequently, while the reform improves the predictability of work incentives for low-to-middle-income earners, it slightly dampens the financial return to additional work at higher earnings levels due to the increased effective marginal tax rate created by the gradual taper.

## Figure 5. A linear childcare fee design would remove METR spikes but at the trade-off of reducing work incentives to increase work effort for higher earners.

Marginal Effective Tax Rates for secondary earners




Note: Calculations refer to a one child (aged 2) couple family with the principal earning the average wage. The second parent increases earnings at the level shown. Full time use of childcare is assumed. It is assumed that the household is eligible to social assistance. Policy reference data: January 1st, 2025. Source: OECD Tax-Benefit Model version 2.8.0.

## Further information

How do taxes and benefits affect disposable household income, benefit replacement rates, and financial work incentives? Find out using the OECD tax-benefit web calculator.

More information on Japan's tax and benefit system is available in the OECD Descriptions of Tax and Benefit Systems

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