

E. Taxation

1. Taxation in Japan

Generally, a non-resident of Japan or non-Japanese corporation (“Non-Resident Holders”) is subject to Japanese withholding tax on dividends paid by Japanese corporations. Stock splits are not subject to Japanese income tax. Due to the 2001 Japanese tax legislation, a conversion of retained earnings or legal reserve (but, not additional paid-in capital, in general) into stated capital (whether made in connection with a stock split or otherwise) is no longer treated as a deemed dividend payment to shareholders for Japanese tax purposes. Thus, such a conversion does not trigger Japanese withholding taxation. (Article 2 (16) of the Japanese Corporation Tax Law and Article 8 (1) (xv) of the Japanese Corporation Tax Law Enforcement Order).

Japan is a party to a number of income tax treaties, conventions and agreements, (collectively “Tax Treaties”), whereby the maximum withholding tax rate for dividend payments is set at, in most cases, 15% for portfolio investors who are Non-Resident Holders. Specific countries with which such Tax Treaties have been entered into include Australia, Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, Luxembourg, The Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, and Switzerland. Pursuant to the Convention Between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, or the Treaty, dividend payments made by a Japanese corporation to a U.S. resident or corporation, unless the recipient of the dividend has a “permanent establishment” in Japan and the shares or ADSs with respect to which such dividends are paid are effectively connected with such “permanent establishment,” will be subject to withholding tax at rate of: (1) 10% for portfolio investors who are qualified U.S. residents eligible for benefits of the Treaty; and (2) 0% (i.e., no withholding) for pension funds which are qualified U.S. residents eligible for benefits of the Treaty, provided that the dividends are not derived from the carrying on of a business, directly or indirectly, by such pension funds. Similar withholding tax treatment applies under the new tax treaty between the United Kingdom and Japan for dividends declared on or after January 1, 2007 due to the renewal of the tax treaty. The tax treaty between France and Japan was renewed effective from January 1, 2008, under which the standard treaty withholding rate for portfolio investors on dividends was reduced from 15% to 10%. In addition, the tax treaty between Australia and Japan was also renewed effective from January 1, 2009, under which the standard treaty withholding rate on dividends will be reduced from 15% to 10%. On the other hand, under the Japanese Income Tax Law, the temporary rate of Japanese withholding tax (“Temporary Rate”) applicable to dividends paid with respect to listed shares, such as those paid by the Company on shares or ADSs, to Non-Resident Holders is currently 7%, which is applicable until December 31, 2011 (the applicable period of the Temporary Rate has been extended pursuant to 2009 Japanese tax legislation). Taking this Temporary Rate into account, the treaty rates such as the 15% rate (or 10% for eligible U.S. residents subject to the Treaty and/or eligible residents subject to other similarly renewed treaties mentioned above) will apply only after the expiration of the Temporary Rate, except for dividends paid to any individual holder who holds 5% or more of the total issued shares for which the applicable rate is 20%. While the treaty rate normally overrides the domestic rate, due to the so-called “preservation doctrine” under Article 1(2) of the Treaty, and/or due to Article 3-2 of the Special Measures Law for the Income Tax Law, Corporation Tax Law and Local Taxes Law with respect to the Implementation of Tax Treaties, if the tax rate under the domestic tax law is lower than that promulgated under the applicable income tax treaty, then the domestic tax rate is still applicable. If the domestic tax rate applies, as will generally be the case until December 31, 2011 for most holders of shares or ADSs who are US residents or corporations, no treaty application is required to be filed.

Gains derived from the sale outside Japan of Japanese corporations’ shares or ADSs by Non-Resident Holders, or from the sale of Japanese corporations’ shares or ADSs within Japan by a non-resident of Japan as an occasional transaction or by a non-Japanese corporation not having a permanent establishment in Japan, are generally not subject to Japanese income or corporation taxes, provided that the seller is a portfolio investor. Japanese inheritance and gift taxes at progressive rates may apply to an individual who has acquired Japanese corporations’ shares or ADSs as a distributee, legatee or donee.

2. Taxation in the United States

The following is a discussion of material U.S. federal income tax consequences of owning and disposing of Canon shares or ADSs to the U.S. holders described below, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular person’s decision to acquire, hold or dispose of such securities. The discussion applies only if you hold Canon shares or ADSs as capital assets for U.S. federal income tax purposes and it does not address special classes of holders, such as:

- certain financial institutions;
- insurance companies;
- dealers and traders in securities or foreign currencies;
- persons holding Canon shares or ADSs as part of a hedge, straddle, conversion, other integrated transaction or other similar transaction;
- persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;
- persons liable for the alternative minimum tax;
- tax-exempt organizations;
- persons holding Canon shares or ADSs that own or are deemed to own 10% or more of any class of Canon stock;
- persons who acquired Canon shares or ADSs pursuant to the exercise of any employee stock option or otherwise as compensation; or
- persons holding shares in connection with trade or business conducted outside of the United States.

This discussion is based on the Internal Revenue Code of 1986, as amended, administrative pronouncements, judicial decision, final, temporary and proposed Treasury regulations and the Treaty, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. It is also based in part on representations by the depository and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. An investor should consult its own tax advisers concerning the U.S. federal, state, local and foreign tax consequences of purchasing, owning and disposing of Canon shares or ADSs in its particular circumstances.

As used herein, a “U.S. holder” is a beneficial owner of Canon shares or ADSs that is, for U.S. federal tax purposes:

- a citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States or any political subdivision thereof; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

In general, if a U.S. holder owns ADSs, it will be treated for U.S. federal income tax purposes as the owner of the underlying shares represented by those ADSs. Accordingly, no gain or loss will be recognized if a U.S. holder exchanges ADSs for the underlying shares represented by those ADSs.

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The U.S. Treasury has expressed concerns that parties to whom American depositary shares are released before shares are delivered to the depository or intermediaries in the chain of ownership between holder and the issuer of the security underlying the American depositary shares, may be taking actions that are inconsistent with the claiming of foreign tax credits for U.S. holders of American depositary shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate U.S. holders. Accordingly, the analysis of the creditability of Japanese taxes and the reduced rates of taxation applicable to dividends received by certain non-corporate U.S. holders, both as described below, could be affected by actions that may be taken by parties to whom ADSs are pre-released.

This discussion assumes that Canon was not a passive foreign investment company for 2008, as described below.

Taxation of Distributions

Distributions paid on Canon shares or ADSs, other than certain pro rata distributions of common shares, to the extent paid out of Canon's current or accumulated earnings and profits (as determined under U.S. federal income tax principles) will be treated as dividends. Because Canon does not maintain calculations of its earnings and profits under U.S. federal income tax principles, it is expected that distributions will be reported to U.S. holders as dividends. The amount of a dividend will include any amounts withheld by Canon or its paying agent in respect of Japanese taxes. The amount of the dividend will be treated as foreign-source dividend income and will not be eligible for the dividends-received deduction generally allowed to U.S. corporations. Subject to applicable limitations that may vary depending upon a U.S. holder's individual circumstances and the concerns expressed by the U.S. Treasury, dividends paid to certain non-corporate holders in taxable years beginning before January 1, 2011 will be taxable at a maximum rate of 15%. Non-corporate U.S. holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Dividends paid in Japanese yen will be included in a U.S. holder's income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt of the dividend by the U.S. holders, in the case of Canon shares, or by the depository, in the case of ADSs, regardless of whether the payment is in fact converted into U.S. dollars at that time. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. holder may have foreign currency gain or loss if the dividend is not converted into U.S. dollars on the date of receipt.

Japanese income taxes withheld from cash dividends on Canon shares or ADSs at a rate not exceeding the rate provided by the Treaty will be creditable against a U.S. holder's U.S. federal income tax liability, subject to applicable limitations that may vary depending upon a U.S. holder's circumstances and the concerns expressed by the U.S. Treasury. Instead of claiming a credit, a U.S. holder may, at its election, deduct such Japanese taxes in computing its income, subject to generally applicable limitations under U.S. law. A U.S. holder should consult its own tax adviser regarding the availability of foreign tax credits in its particular circumstances.

Sale and Other Disposition of Canon Shares or ADSs

For U.S. federal income tax purposes, gain or loss a U.S. holder realizes on the sale or other disposition of Canon shares or ADSs will be capital gain or loss, and will be long-term capital gain or loss if such holder held the Canon shares or ADSs for more than one year. The amount of a U.S. holder's gain or loss will be equal to the difference between its U.S. dollar tax basis in the Canon shares or ADSs disposed of and the U.S. dollar amount realized on the disposition. Such gain or loss will generally be U.S. source gain or loss for foreign tax credit purposes.

Passive Foreign Investment Company Rules

Canon believes that it was not a passive foreign investment company ("PFIC") for U.S. federal income tax purposes for fiscal 2008. However, since PFIC status depends upon the composition of Canon's income and assets and the market value of its assets (including, among others, goodwill and equity investments in less than 25% owned entities) from time to time, there can be no assurance that Canon will not be considered a PFIC for any taxable year. If Canon were treated as a PFIC for any taxable year during which a U.S. holder held Canon shares or ADSs, certain adverse tax consequences could apply to such U.S. holder.

If Canon were treated as a PFIC for any taxable year during which a U.S. holder held Canon shares or ADSs, gain recognized by a U.S. holder on the sale or other disposition of Canon shares or ADSs would be allocated ratably over its holding period for such securities. The amounts allocated to the taxable year of the sale or other disposition and to any year before Canon became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect in such taxable year for individuals or corporations, as appropriate, and an interest charge would be imposed on the tax liability attributable to such allocated amounts. Further, any distribution in respect of Canon shares or ADSs in excess of 125% of the average of the annual distributions on such securities received by a U.S. holder during the preceding three years or its holding period, whichever is shorter, would be subject to taxation as described above. Certain elections (including a mark-to-market election) may be available to a U.S. holder that may mitigate the adverse tax consequences resulting from PFIC status.

In addition, if Canon were treated as a PFIC in a taxable year in which it pays a dividend or the prior taxable year, the 15% dividend rate discussed above with respect to dividends paid to certain non-corporate U.S. holders would not apply.

Information Reporting and Backup Withholding

Payment of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and to backup withholding unless the U.S. holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. holder provides a correct taxpayer identification number and certify that no loss of exemption from backup withholding has occurred.

The amount of any backup withholding from a payment to a U.S. holder will be allowed as a credit against such holder's U.S. federal income tax liability and may entitle it to a refund, provided that the required information is furnished to the Internal Revenue Service.

F. Dividends and paying agents

Not applicable.

G. Statement by experts

Not applicable.