

Dividend

This article is about financial dividends. For dividends in arithmetic, see [Division \(mathematics\)](#).

A **dividend** is a payment made by a corporation to its shareholders, usually as a distribution of profits.^[1] When a corporation earns a profit or surplus, it can re-invest it in the business (called [retained earnings](#)), and pay a fraction of this reinvestment as a dividend to shareholders. Distribution to shareholders can be in cash (usually a deposit into a bank account) or, if the corporation has a [dividend reinvestment plan](#), the amount can be paid by the issue of further shares or [share repurchase](#).^{[2][3]}

A dividend is allocated as a fixed amount per share, with shareholders receiving a dividend in proportion to their shareholding. For the joint stock company, paying dividends is not an expense; rather, it is the division of after tax profits among shareholders. Retained earnings (profits that have not been distributed as dividends) are shown in the shareholders' equity section on the company's balance sheet - the same as its issued share capital. Public companies usually pay dividends on a fixed schedule, but may declare a dividend at any time, sometimes called a [special dividend](#) to distinguish it from the fixed schedule dividends. Cooperatives, on the other hand, allocate dividends according to members' activity, so their dividends are often considered to be a pre-tax expense.

The word "dividend" comes from the Latin word "*dividendum*" ("thing to be divided").^[4]

1 Forms of payment

Cash dividends are the most common form of payment and are paid out in currency, usually via [electronic funds transfer](#) or a printed paper [check](#). Such dividends are a form of investment income and are usually taxable to the recipient in the year they are paid. This is the most common method of sharing corporate profits with the shareholders of the company. For each share owned, a declared amount of money is distributed. Thus, if a person owns 100 shares and the cash dividend is 50 cents per share, the holder of the stock will be paid \$50. Dividends paid are not classified as an expense, but rather a deduction of [retained earnings](#). Dividends paid does not show up on an [income statement](#) but does appear on the [balance sheet](#).

Stock or scrip dividends are those paid out in the form of additional stock shares of the issuing corporation, or

another corporation (such as its subsidiary corporation). They are usually issued in proportion to shares owned (for example, for every 100 shares of stock owned, a 5% stock dividend will yield 5 extra shares).

Nothing tangible will be gained if the stock is split because the total number of shares increases, lowering the price of each share, without changing the [market capitalization](#), or total value, of the shares held. (See also [Stock dilution](#).)

Stock dividend distributions are issues of new shares made to limited partners by a partnership in the form of additional shares. Nothing is split, these shares increase the market capitalization and total value of the company at the same time reducing the original cost basis per share.

Stock dividends are not includable in the gross income of the shareholder for US income tax purposes. Because the shares are issued for proceeds equal to the pre-existing market price of the shares; there is no negative dilution in the amount recoverable.^{[5][6][7]}

Property dividends or dividends *in specie* (Latin for "in kind") are those paid out in the form of assets from the issuing corporation or another corporation, such as a subsidiary corporation. They are relatively rare and most frequently are securities of other companies owned by the issuer, however they can take other forms, such as products and services.

Interim dividends are dividend payments made before a company's Annual General Meeting (AGM) and final financial statements. This declared dividend usually accompanies the company's interim financial statements.

Other dividends can be used in [structured finance](#). Financial assets with a known market value can be distributed as dividends; warrants are sometimes distributed in this way. For large companies with subsidiaries, dividends can take the form of shares in a subsidiary company. A common technique for "spinning off" a company from its parent is to distribute shares in the new company to the old company's shareholders. The new shares can then be traded independently.

2 Reliability of dividends

Two metrics are commonly used to examine a firm's dividend policy.

Payout ratio is calculated by dividing the company's dividend by the [earnings per share](#). A payout ratio greater

than 1 means the company is paying out more in dividends for the year than it earned.

Dividend cover is calculated by dividing the company's cash flow from operations by the dividend. This ratio is apparently popular with analysts of income trusts in Canada. Dividends are payments made by a corporation to its shareholder members. It is the portion of corporate profits paid out to stockholders.

3 Dividend dates

A dividend that is declared must be approved by a company's board of directors before it is paid. For public companies, four dates are relevant regarding dividends:^[8]

Declaration date — the day the board of directors announces its intention to pay a dividend. On that day, a liability is created and the company records that liability on its books; it now owes the money to the stockholders.

In-dividend date — the last day, which is one trading day before the *ex-dividend date*, where the stock is said to be *cum dividend* ('with [including] dividend'). In other words, existing holders of the stock and anyone who buys it on this day will receive the dividend, whereas any holders selling the stock lose their right to the dividend. After this date the stock becomes *ex dividend*.

Ex-dividend date — the day on which shares bought and sold no longer come attached with the right to be paid the most recently declared dividend. In the United States, it is typically 2 trading days before the *record date*. This is an important date for any company that has many stockholders, including those that trade on exchanges, to enable reconciliation of who is entitled to be paid the dividend. Existing holders of the stock will receive the dividend even if they sell the stock on or after that date, whereas anyone who bought the stock will not receive the dividend. It is relatively common for a stock's price to decrease on the ex-dividend date by an amount roughly equal to the dividend paid. This reflects the decrease in the company's assets resulting from the declaration of the dividend.

Book closure date — when a company announces a dividend, it will also announce a date on which the company will ideally temporarily close its books for fresh transfers of stock, which is also usually the record date.

Record date — shareholders registered in the company's record as at the record date will be paid the dividend. Shareholders who are not registered as of this date will not receive the dividend. Registration in most countries is essentially automatic for shares purchased before the ex-dividend date.

Payment date — the day on which the dividend cheques will actually be mailed to shareholders or credited to their bank account.

4 Dividend-reinvestment

Some companies have dividend reinvestment plans, or DRIPs, not to be confused with scrips. DRIPs allow shareholders to use dividends to systematically buy small amounts of stock, usually with no commission and sometimes at a slight discount. In some cases, the shareholder might not need to pay taxes on these re-invested dividends, but in most cases they do.

5 Dividend taxation

Main article: Dividend tax

Most countries impose a corporate tax on the profits made by a company. A dividend paid by a company is not an expense of the company, but is income of the shareholder. The tax treatment of this dividend income varies considerably between countries:

5.1 United States and Canada

The United States and Canada impose a lower tax rate on dividend income than ordinary income, on the basis that company profits had already been taxed as corporate tax.

5.2 Australia and New Zealand

Australia and New Zealand have a dividend imputation system, wherein companies can attach franking credits or imputation credits to dividends. These franking credits represent the tax paid by the company upon its pre-tax profits. One dollar of company tax paid generates one franking credit. Companies can attach any proportion of franking up to a maximum amount that is calculated from the prevailing company tax rate: for each dollar of dividend paid, the maximum level of franking is the company tax rate divided by (1 - company tax rate). At the current 30% rate, this works out at 0.30 of a credit per 70 cents of dividend, or 42.857 cents per dollar of dividend. The shareholders who are able to use them, apply these credits against their income tax bills at a rate of a dollar per credit, thereby effectively eliminating the double taxation of company profits.

5.3 United Kingdom

The UK's taxation system operates along similar lines to Australia and New Zealand: when a shareholder receives a dividend, the basic rate of income tax is deemed to already have been paid on that dividend. This ensures that double taxation does not take place, however this creates difficulties for some non-taxpaying entities such as certain trusts, charities and pension funds which are not al-

lowed to reclaim the deemed tax payment and thus are in effect taxed on their income.

5.4 India

In India, companies declaring or distributing dividend, are required to pay a Corporate Dividend Tax in addition to the tax levied on their income. The dividend received by the shareholders is then exempt in their hands.

6 Effect on stock price

After a stock goes ex-dividend (i.e. when a dividend has just been paid, so there is no anticipation of another imminent dividend payment), the stock price should drop.

To calculate the amount of the drop, the traditional method is to view the financial effects of the dividend from the perspective of the company. Since the company has paid say £x in dividends per share out of its cash account on the left hand side of the balance sheet, the equity account on the right side should decrease an equivalent amount. This means that a £x dividend should result in a £x drop in the share price.

A more accurate method of calculating this price is to look at the share price and dividend from the after-tax perspective of a share holder. The after-tax drop in the share price (or capital gain/loss) should be equivalent to the after-tax dividend. For example, if the tax of capital gains T_{cg} is 35%, and the tax on dividends T_d is 15%, then a £1 dividend is equivalent to £0.85 of after tax money. To get the same financial benefit from a capital loss, the after tax capital loss value should equal £0.85. The pre-tax capital loss would be $£0.85/(1-T_{cg}) = £0.85/(1-35\%) = £0.85/65\% = £1.30$. In this case, a dividend of £1 has led to a larger drop in the share price of £1.30, because the tax rate on capital losses is higher than the dividend tax rate.

Finally, security analysis that does not take dividends into account may mute the decline in share price, for example in the case of a Price-earnings ratio target that does not back out cash; or amplify the decline, for example in the case of Trend following.

6.1 Criticism

Some believe that company profits are best re-invested back into the company: research and development, capital investment, expansion, etc. Proponents of this view (and thus critics of dividends per se) suggest that an eagerness to return profits to shareholders may indicate the management having run out of good ideas for the future of the company. Some studies, however, have demonstrated that companies that pay dividends have higher earnings growth, suggesting that dividend payments may

be evidence of confidence in earnings growth and sufficient profitability to fund future expansion.^[9]

Taxation of dividends is often used as justification for retaining earnings, or for performing a stock buyback, in which the company buys back stock, thereby increasing the value of the stock left outstanding.

When dividends are paid, individual shareholders in many countries suffer from double taxation of those dividends:

1. the company pays income tax to the government when it earns any income, and then
2. when the dividend is paid, the individual shareholder pays income tax on the dividend payment.

In many countries, the tax rate on dividend income is lower than for other forms of income to compensate for tax paid at the corporate level.

Capital gains should not be confused with dividends. Capital gains assume an increase in a stock's value. Dividend is merely parsing out a share of the profits, and is taxed at the dividend tax rate. If there is an increase of value of stock, and a shareholder chooses to sell the stock, the shareholder will pay a tax on capital gains (often taxed at a lower rate than ordinary income). If a holder of the stock chooses to not participate in the buyback, the price of the holder's shares could rise (as well as it could fall), but the tax on these gains is delayed until the actual sale of the shares.

Certain types of specialized investment companies (such as a REIT in the U.S.) allow the shareholder to partially or fully avoid double taxation of dividends.

Shareholders in companies that pay little or no cash dividends can reap the benefit of the company's profits when they sell their shareholding, or when a company is wound down and all assets liquidated and distributed amongst shareholders. This, in effect, delegates the dividend policy from the board to the individual shareholder. Payment of a dividend can increase the borrowing requirement, or leverage, of a company.

7 Other corporate entities

7.1 Cooperatives

Cooperative businesses may retain their earnings, or distribute part or all of them as dividends to their members. They distribute their dividends in proportion to their members' activity, instead of the value of members' shareholding. Therefore, co-op dividends are often treated as pre-tax expenses. In other words, local tax or accounting rules may treat a dividend as a form of customer rebate or a staff bonus to be deducted from turnover before profit (tax profit or operating profit) is calculated.

Consumers' cooperatives allocate dividends according to their members' trade with the co-op. For example, a credit union will pay a dividend to represent interest on a saver's deposit. A retail co-op store chain may return a percentage of a member's purchases from the co-op, in the form of cash, store credit, or equity. This type of dividend is sometimes known as a patronage dividend or **patronage refund**, as well as being informally named *divi* or *divvy*.^{[10][11][12]}

Producer cooperatives, such as worker cooperatives, allocate dividends according to their members' contribution, such as the hours they worked or their salary.^[13]

7.2 Trusts

In real estate investment trusts and royalty trusts, the distributions paid often will be consistently greater than the company earnings. This can be sustainable because the accounting earnings do not recognize any increasing value of real estate holdings and resource reserves. If there is no economic increase in the value of the company's assets then the excess distribution (or dividend) will be a return of capital and the book value of the company will have shrunk by an equal amount. This may result in capital gains which may be taxed differently from dividends representing distribution of earnings.

7.3 Mutuals

The distribution of profits by other forms of mutual organization also varies from that of joint stock companies, though may not take the form of a dividend.

In the case of mutual insurance, for example, in the United States, a distribution of profits to holders of participating life policies is called a *dividend*. These profits are generated by the investment returns of the insurer's general account, in which premiums are invested and from which claims are paid.^[14] The participating dividend may be used to decrease premiums, or to increase the cash value of the policy.^[15] Some life policies pay nonparticipating dividends. As a contrasting example, in the United Kingdom, the surrender value of a with-profits policy is increased by a *bonus*, which also serves the purpose of distributing profits. Life insurance dividends and bonuses, while typical of mutual insurance, are also paid by some joint stock insurers.

Insurance dividend payments are not restricted to life policies. For example, general insurer State Farm Mutual Automobile Insurance Company can distribute dividends to its vehicle insurance policyholders.^[16]

8 See also

- Dividend cover

- Dividend policy
- Dividend tax
- Dividend units
- Dividend yield
- Special dividend
- Liquidating dividend
- Qualified dividend
- P/E ratio
- List of companies paying monthly dividends
- List of companies paying scrip dividends
- CSS dividend policy

9 References

- [1] Sullivan, Arthur; Steven M. Sheffrin (2003). *Economics: Principles in action*. Upper Saddle River, New Jersey 07458: Pearson Prentice Hall. p. 273. ISBN 0-13-063085-3.
- [2] Michael Simkovic, "The Effect of Enhanced Disclosure on Open Market Stock Repurchases", 6 Berkeley Bus. L.J. 96 (2009).
- [3] Amedeo De Cesari, Susanne Espenlaub, Arif Khurshed and Michael Simkovic, "The Effects of Ownership and Stock Liquidity on the Timing of Repurchase Transactions", 2010
- [4] "dividend". *Online Etymology Dictionary*. Douglas Harper. 2001. Retrieved November 9, 2006.
- [5] Public offering Kinder Morgan Management, LLC
- [6] U.S. Securities and Exchange Commission
- [7] EDGAR Online, Inc.
- [8] Securities and Exchange Commission site
- [9] Robert D. Arnott and Clifford S. Asness (January–February 2003). "Surprise! Higher Dividends equal Higher Earnings Growth". *Financial Analysts Journal*. Retrieved January 4, 2011.
- [10] Ace Hardware (March 22, 2001). "Annual Report, Section 1, Business, 10-K405 SEC Filing".
- [11] "Co-op pays out £19.6m in 'divi'". BBC News via bbc.co.uk. June 28, 2007. Retrieved May 15, 2008.
- [12] Nikola Balnave and Greg Patmore. "The History Cooperative – Conference Proceedings - ASSLH - Rochdale consumer co-operatives and Australian labour history".
- [13] Norris, Sue (March 3, 2007). "Cooperatives pay big dividends". *The Guardian*. Retrieved June 9, 2009.

- [14] "What Are Dividends?". New York Life. Retrieved April 29, 2008. In short, the portion of the premium determined not to have been necessary to provide coverage and benefits, to meet expenses, and to maintain the company's financial position, is returned to policyowners in the form of dividends.
- [15] Hoboken, NJ (2002). "24, Investment-Oriented Life Insurance". In Fabozzi, Frank J. *Handbook of Financial Instruments*. Wiley. p. 591. ISBN 0-471-22092-2. OCLC 52323583.
- [16] "State Farm Announces \$1.25 Billion Mutual Auto Policyholder Dividend". State Farm. March 1, 2007.

10 External links

- Ex-Dividend Dates: When Are You Entitled to Stock and Cash Dividends – U.S. Securities and Exchange Commission
- Why Should Companies Pay Dividends?
- Dividend Policy from studyfinance.com at the University of Arizona
- Common Stock Dividends Ex-Dividend Dates for Common Stock Dividends
- Dividend Portfolio Example & the Importance of Dividend Investing
- The new U.S. dividend tax cut traps from Tennessee CPA Journal, Nov. 2004
- UK Dividend Tax Rates
- Special Dividends How To Profit From Special Dividends
- Dividend Income from China

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11.1 Text

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