

How Dividends Work

Imagine owning a slice of a successful pizza shop. Every time the business makes a profit, the owners share some of that extra dough with partners—like you—by handing out cash or more slices. That's dividends in a nutshell: a way for companies to reward shareholders (owners) for investing in them. Dividends provide a steady stream of income on top of any growth in the stock's price.

This guide breaks it down step by step, in plain English, so you can see how dividends fit into your financial picture with confidence.

What Are Dividends and Why Do Companies Pay Them?

Dividends are portions of a company's profits distributed to shareholders—most often in cash, but sometimes as additional stock. Companies pay them to share success, attract income-focused investors (like retirees), and signal financial strength.

Not every company pays dividends. Growth firms—such as many in technology or AI—often reinvest profits to expand instead. Mature, steady businesses like utilities, consumer staples, and energy companies tend to pay dividends more consistently. Historically, dividends have accounted for roughly 40% of the S&P 500's long-term total return, blending growth with reliable income.

How Do Dividends Work? Step by Step

Dividends follow a predictable process, usually on a quarterly basis:

1. **Declaration Date** – The board announces the dividend (e.g., \$0.50 per share) and sets the timeline.
2. **Ex-Dividend Date** – To receive the payout, you must own shares before this date. Buying on or after it means you'll miss that dividend.
3. **Record Date** – The company checks shareholder records to confirm who qualifies.
4. **Payment Date** – The dividend is paid, typically a few weeks later.

Example: If you own 100 shares of Procter & Gamble (PG), which pays about \$1.01 per share quarterly in 2025, you'd receive \$101 every three months (\$404 annually). With PG trading around \$160, that equals a 2.5% yield—steady income without selling shares.

Keep in mind: dividends are not guaranteed. Companies may reduce or suspend them during tough times. Firms known as “dividend aristocrats,” however—those that have increased dividends for 25+ years—tend to be more reliable.

Types of Dividends

- **Cash Dividends** – The most common; paid directly into your brokerage account.
- **Stock Dividends** – Additional shares instead of cash, increasing your holdings.
- **Special Dividends** – One-time payouts from extraordinary profits.

Dividend Taxes

Dividends fall into two tax categories:

- **Qualified Dividends** – From U.S. and certain foreign companies, held long enough (60+ days around ex-date). Taxed at long-term capital gains rates (0%, 15%, or 20%).
- **Ordinary Dividends** – Don't meet the criteria; taxed at regular income rates.

For 2025 tax filings:

- **0% Rate** – Income below \$48,350 (single) / \$96,700 (married).
- **15% Rate** – Up to \$609,350 (single) / \$731,200 (married).
- **20% Rate** – Above those thresholds.

High earners may also owe a 3.8% Net Investment Income Tax. In taxable accounts, qualified dividends are generally more tax-efficient. Holding dividend-paying stocks in IRAs or retirement accounts can defer or eliminate taxes entirely.

The Power of Reinvesting

Many investors use Dividend Reinvestment Plans (DRIPs) to automatically purchase more shares with payouts, compounding growth over time.

Example: Reinvesting that \$101 quarterly dividend from PG could grow your 100 shares to more than 150 over 10 years, assuming stable dividends and prices. Small additions snowball into meaningful growth.

Pros and Cons of Dividend Investing

Benefits:

- Reliable income stream

- Stability in downturns
- Compounding potential via reinvestment
- Favorable tax treatment for qualified dividends

Risks:

- Dividends aren't guaranteed
 - High yields may signal company trouble
 - Potentially lower growth vs. non-dividend-paying stocks
 - Tax considerations in taxable accounts
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Getting Started

Dividends are profit-sharing payments that can provide steady income, tax advantages, and long-term compounding power. They can play an important role in building a balanced portfolio.

If you'd like to explore how dividends could support your financial goals, schedule a consultation with our team at **Landis Wealth Management**.

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