Tax Planning Advisory

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IRS Ruling Creates Opportunities for Tax Savings by Companies With Substantial Real Estate Assets

On July 29, Windstream announced that it plans to spin off certain telecommunications network assets into an independent, publicly traded real estate investment trust (REIT). Windstream made the announcement after it obtained a favorable private letter ruling from the Internal Revenue Service (IRS) regarding the tax-free nature of the spin-off and the qualification of the spun-off entity's assets as real property for REIT purposes.

Under the transaction, Windstream will spin off its existing fiber and copper network, real estate, and other fixed assets into a publicly traded, independent REIT. The REIT's primary activity will be to lease the use of the assets back to Windstream through a long-term "triple net" exclusive lease. Windstream shareholders will retain their existing shares and receive shares in the REIT commensurate with their Windstream ownership. The transaction is intended to effectively enable Windstream to deduct, for federal income tax purposes, the amount of rent paid to the REIT without a corresponding corporate level income tax inclusion in income by the REIT—estimated to generate up to a $650 million annual overall reduction in taxable income between Windstream and the REIT.

Particularly notable about this transaction is that the private letter ruling obtained by Windstream is seemingly an indication by the IRS that it will respect the tax-free transaction of a spin-off even when coupled with an election for REIT status. The fact that the ruling recognized transmission infrastructure (e.g., wires and cable), in addition to the related real estate, as qualifying assets for REIT purposes is also a key development. The IRS issued proposed regulations in May that provided more specific guidance on what types of assets would be considered "real property" for purposes of meeting the requirements for making a REIT election, and Windstream's private letter ruling is among the first to address the issue in light of the new regulations.

These developments mean that a REIT spin-off transaction might be available to many kinds of businesses. Companies (other than master limited partnerships) with similar assets, such as telecommunications, cables, fiber optics, and data centers, may be wise to explore opportunities to realize substantial tax savings through a similar transaction. However, there are several challenges that must be overcome to execute a successful REIT spin-off transaction.

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