

## DEPARTMENT OF STATE REVENUE

Revenue Ruling #2019-10ST  
October 2, 2020

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## ISSUES

**Sales and Use Tax - Tangible Personal Property Converted into Real Property**

**Authority:** [IC 6-2.5-1-14.7](#); [IC 6-2.5-1-14.9](#); [IC 6-2.5-1-27](#); [IC 6-2.5-1-27.7](#); [IC 6-2.5-2-1](#); [IC 6-2.5-2-2](#); [IC 6-2.5-3-2](#); [IC 6-2.5-4-1](#); [IC 6-2.5-4-9](#); [IC 6-2.5-5-3](#); [IC 6-2.5-8-8](#); [IC 6-8.1-5-4](#); [45 IAC 2.2-4-2](#); [45 IAC 2.2-5-8](#); *Indiana Dep't of State Revenue v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); Sales Tax Information Bulletin #60 (November 2017).

A taxpayer ("Contractor") is seeking an opinion as to the tax treatment of its product lines that it uses to construct cleanrooms for its manufacturer clients. Specifically, Contractor asks the following:

1. Whether Contractor's product lines are subject to Indiana sales tax when Contractor purchases the materials or would Contractor collect sales tax on the billings to their customers?
2. Whether the answer to Issue #1 would differ if the project was billed with a separated labor and materials billing or as a lump sum billing, or if Contractor worked as a subcontractor or directly for the project owner?
3. Would any of these product lines qualify for the manufacturing exemption under [IC 6-2.5-5-3](#)?
4. If the answer to Issue #3 is that the exemption does apply, what documentation would Contractor need to receive from their customers to support the exemption? Further, would the answer differ if their customers were a general contractor or the owner of the project?
5. What documentation or certificate would Contractor need to provide to their vendors to purchase materials exempt from sales tax?
6. Whether pre-construction design services are subject to sales tax? Further, would the answer differ if this was a stand-alone service or if it was included with the construction of the cleanroom?

## STATEMENT OF FACTS

Contractor performs specialty contracting work throughout the United States. One type of specialty work that Contractor performs is the building of cleanrooms that are generally used in manufacturing or scientific research in the life science or microelectronics industries. Contractor is generally included on such projects as a subcontractor working for the general contractor, but they do occasionally perform this work directly for the owner of the project. Contractor explains that they must create a controlled environment that regulates humidity, temperature, particulate matter, and contamination. Contractor claims it is vital to the products or research being produced within the cleanroom that they construct the cleanrooms in such a manner. Contractor uses the following materials for the two types of industries in which it offers cleanroom construction:

**Life Science Industry:**

- Modular Wall & Ceiling Systems - includes walk-on ceilings, modular walls, or a combination of modular and stick built construction.
- Traditional Wall & Ceiling Systems - traditional drywall finishes which can be combined with modular systems.
- Specialty Doors - Contractor installs doors in a variety of configurations such as swing, sliding, and high-speed roll up doors.
- Laminar Flow Solutions - Contractor offers a wide range of laminar flow and air filtration solutions available, such as containment hoods, stainless steel plenums and air handling units.
- Lighting Systems - Contractor can install many lighting system options including walk-on, surface mounted and LEDs.
- Flooring Solutions - This includes a wide range including resinous floor solutions, various thicknesses, chemistries and finishes comprised of epoxy, vinyl flake or sheet vinyl systems. Vinyl seams are heat-welded, providing an impervious, hard-wearing, homogeneous floor finish. Floor coves are often

incorporated into walls for ease of cleaning. In addition, Contractor offers the accurate configuration of raised access flooring to adhere to under-floor mechanical and electrical component specifications.

- Filtration Systems - Contractor can install filtration systems that are integrated and installed into the cleanroom facility.
- Specialties - Contractor provides a variety of specialty items such as slotted channels, pass throughs, utility boxes, grids and curtains, guard rails, bumper guards and gown room furniture.
- Cold Room Integration - Contractor creates the cold room with materials that meet the overall cleanroom specifications.

#### **Microelectronics/Semiconductor Industry:**

- Modular Wall & Ceiling Systems - This includes walk-on ceilings, modular walls, or a combination of modular and stick built construction.
- Air Filtration Systems - From fan-filter units, ducted filter units, plenums, and air handling units, Contractor delivers customized solutions to maximize the most sensitive and critical area of your manufacturing process.
- Specialty Doors - Contractor installs doors in a variety of configurations such as swing, sliding, and high-speed roll up doors.
- Flooring Solutions - This includes a wide range including resinous floor solutions, various thicknesses, chemistries and finishes comprised of epoxy, vinyl flake or sheet vinyl systems. Vinyl seams are heat-welded, providing an impervious, hard-wearing, homogeneous floor finish. Floor coves are often incorporated into walls for ease of cleaning. In addition, Contractor offers the accurate configuration of raised access flooring to adhere to under-floor mechanical and electrical component specifications.
- Strut Utility Racks - Contractor can install unistrut slot channel framing to serve a variety of support system applications. These include cable management, pipe and conduit, and HVAC and duct, lighting and equipment supports.
- Specialties - Contractor provides a variety of specialty items such as slotted channels, pass throughs, utility boxes, grids and curtains, guard rails, bumper guards and gown room furniture.
- Automated Material Handling Systems - Contractor can install cleanroom automation systems for a variety of industries, applications, and automated system types including conveyors, carousels, storage retrieval and guided vehicles.
- Tool Installation Services - Contractor provides a complete, comprehensive solution for tool installation services from system rigging to the final outfitting of technical instruments and machinery.
- Protocol, Cleaning and Certification Services - Contractor provides onsite operations training and staff monitoring throughout the construction process to ensure the cleanroom environment is not comprised. Contractor also offers postconstruction cleaning and sanitization services to eliminate debris and static buildup through full super cleans and particle testing.

#### **DISCUSSION**

Pursuant to [IC 6-2.5-2-1\(a\)](#) and [IC 6-2.5-2-2\(a\)](#), sales tax is imposed on retail transactions made in Indiana. [IC 6-2.5-4-1\(a\)](#) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." A retail transaction is defined in [IC 6-2.5-4-1\(b\)](#) as the transfer, in the ordinary course of business, of tangible personal property for consideration. [IC 6-2.5-4-1](#) goes on to provide in pertinent part:

For purposes of determining what constitutes selling at retail, it does not matter whether:

. . .

(2) the property is transferred alone or in conjunction with other property or services . . .

(e) The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:

(1) the price of the property transferred, without the rendition of any service; and

(2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

"Tangible personal property" is defined in [IC 6-2.5-1-27](#) as:

. . . personal property that:

(1) can be seen, weighed, measured, felt, or touched; or

(2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

[IC 6-2.5-4-9](#) explains a contractor's sales and use tax liability in construction contracts as follows:

(a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:

(1) is to be added to a structure or facility by the purchaser; and

(2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.

(b) A contractor is a retail merchant making a retail transaction when the contractor:

(1) disposes of tangible personal property; or

(2) converts tangible personal property into real property;

under a time and material contract. As such a retail merchant, a contractor described in this subsection shall collect, as an agent of the state, the state gross retail tax on the resale of the construction material and remit the state gross retail tax as provided in this article.

(c) Notwithstanding subsections (a) and (b), a transaction described in subsection (a) or (b) is not a retail transaction, if the ultimate purchaser or recipient of the property to be added to the structure or facility would be exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

A contractors' use tax responsibilities with respect to the purchase, use, and sale of construction material are found in subsection (c) of [IC 6-2.5-3-2](#), which provides the following:

(c) The use tax is imposed on a contractor's conversion of construction material into real property if that construction material was purchased by the contractor. However, the use tax does not apply to conversions of construction material described in this subsection, if:

(1) the state gross retail or use tax has been previously imposed on the contractor's acquisition or use of that construction material;

(2) the person for whom the construction material is being converted could have purchased the material exempt from the state gross retail and use taxes, as evidenced by a properly issued exemption certificate, if that person had directly purchased the construction material from a retail merchant in a retail transaction; or

(3) the conversion of the construction material into real property is governed by a time and material contract as described in [IC 6-2.5-4-9\(b\)](#).

"Construction material" is defined in [IC 6-2.5-1-14.7](#) as "any tangible personal property to be converted into real property." [IC 6-2.5-1-14.9](#) defines "Contractor" as "any person engaged in converting construction material into real property on behalf of another person. The term includes, but is not limited to, general or prime contractors, subcontractors, and specialty contractors." Finally, "time and material contract" is defined by statute at [IC 6-2.5-1-27.7](#) to mean "a contract in which the cost of construction material and the cost of labor or other charges are stated separately."

Sales Tax Information Bulletin #60 (November 2017) provides additional guidance as to how the Department determines whether or not items remain tangible personal property:

"Construction Material" means any tangible personal property to be converted into real property.

1. Examples of construction material that may be converted into real property through incorporation or installation include, but are not limited to, doors, garage doors, windows, cabinets, garbage disposals, water heaters, water softeners, alarms, furnaces, central air conditioning units, gutters, carpeting and other flooring materials, drywall, lumber, asphalt, concrete, fencing, trees, shrubbery, and pre-fabricated construction material.

2. Examples of items that typically remain tangible personal property, and, therefore, *are not* considered construction material, include, but are not limited to, personal computers, televisions, refrigerators, stoves, dishwashers, clothes washers and dryers, window air conditioning units, and other removable items such as furniture.

3. Construction material that has been converted into real property when it has been attached to or incorporated into real property in such a way that would lead one to reasonably believe the construction material has been permanently affixed to the real property. Construction material incorporated into real property becomes part of and indistinguishable from the real property into which it has been incorporated.

4. Conversions of tangible personal property into real property include incorporations and installations of tangible personal property into facilities or structures. Incorporations and installations of tangible personal property into facilities or structures may include improvements to and repairs of existing facilities or structures.

There is a difference in the tax collection and remittance requirements for construction material purchased by a contractor depending on whether the contractor is operating under a time and material contract or non-time and material contract (in this case, a lump sum contract). In interpreting the [IC 6-2.5-4-9\(b\)](#), Sales Tax Information Bulletin #60 provides that "contractors are retail merchants selling construction material when they (1) dispose of, or (2) convert construction material into real property under a time and material contract." Due to sales of tangible personal property being subject to sales tax, which includes construction materials, "contractors converting construction material into real property under a time and material contract must collect and remit sales tax on the material portion of their contracts." Id.

On the other hand, in interpreting [IC 6-2.5-3-2\(c\)](#), the bulletin provides that when operating under a lump sum contract, contractors "purchase construction material for their own use or consumption in the fulfillment of contractual obligations to provide real property improvement services." Therefore, when a contractor operates this way, they "are not reselling construction material and should not charge their customers sales tax." Id. A lump sum contractor's tax obligations would be the following:

- (1) pay sales tax at the time the construction material is purchased; or
- (2) self-assess and remit use tax at the time the construction material is converted into real property if that construction material was purchased or otherwise acquired without paying tax.

Id.

Whether Contractor operates as a subcontractor or directly for the project owner might impact the tax responsibility with regards to the general contractor. This can be illustrated in four different scenarios where Contractor acts as a subcontractor working for a prime contractor on the construction of a cleanroom, changing the combination of construction contracts each could use:

1. Contractor and a prime contractor both operate under a time and material contract. The Contractor is responsible for buying the cleanroom components of the cleanroom. Since the Contractor operates under a time and material contract, they are a retail merchant, and therefore they can purchase the cleanroom components from their vendor exempt from sales tax under the sale for resale exemption. Because Contractor is a retail merchant selling the construction material it incorporates into the cleanroom, the transaction between the Contractor and the prime contractor is a taxable retail transaction. However, as another retail merchant, the prime contractor can purchase the construction material exempt from Contractor under the sale for resale exemption as well. Prime contractor would then charge sales tax to the customer on the material portion of Contractor's materials.
2. Contractor operates under a lump sum contract, while the prime contractor operates under a time and materials contract with the customer. Contractor is responsible for buying the cleanroom components. Since they do not operate under a time and material contract, they are not a retail merchant, and therefore they pay sales tax on their cleanroom components from their vendor. Because the contract between Contractor and prime contractor is not a taxable retail transaction, prime contractor is not charged sales tax by the Contractor. Prime contractor has not purchased materials from Contractor, and therefore they do not charge their customer sales tax on the materials from the Contractor's contract.
3. Contractor operates under a time and material contract, while the prime contractor operates under a lump sum contract with the customer. Contractor is responsible for buying the cleanroom components. Since Contractor operates under a time and material contract, they are a retail merchant, and therefore they can purchase the cleanroom components from their vendor exempt from sales tax under the sale for resale exemption. Because the contract between Contractor and prime contractor is a taxable retail transaction, prime contractor is charged sales tax by the Contractor. However, because prime contractor is not a time and material contractor, the contract between the prime contractor and the customer is not a taxable retail transaction, and therefore they do not charge the customer sales tax.
4. Contractor operates under a lump sum contract, as does the prime contractor with the customer. The Contractor is responsible for buying the cleanroom components. Since they do not operate under a time and material contract, they are not a retail merchant, and therefore they pay sales tax on their cleanroom

components from their vendor. The prime contractor is not charged sales tax by the Contractor because the contract between them is not a taxable retail transaction. Similarly, because the prime contractor does not operate under a time and material contract, they are also not a retail merchant engaging in a taxable retail transaction, and therefore they do not charge the customer sales tax either.

Regarding the application of the manufacturing exemption to Contractor's product lines, there is an exemption from sales tax for machinery, tools, or equipment that will be directly used in direct manufacturing and production at [IC 6-2.5-5-3\(b\)](#). More context on the exemption at [IC 6-2.5-5-3](#) is provided in the Department's regulations. [45 IAC 2.2-5-8\(c\)](#) provides that machinery, tools, and equipment qualify for the exemption only if they have an "immediate effect" on the article produced and are "an essential and integral part of an integrated process which produces tangible personal property." Furthermore, [45 IAC 2.2-5-8\(g\)](#) goes on to provide the following:

Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

In looking over the product lines, it is not possible to say with certainty that any of the items would be exempt from sales tax, with the exception of the Protocol, Cleaning and Certification Services (to the extent that only a *de minimis* amount of tangible personal property is conferred with the services if this is a unitary or bundled charge for the service). It is important to note that the taxpayer claiming an exemption has the burden of showing the terms of the exemption statute are met. *Indiana Dep't of State Revenue v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). Additionally, "where such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.*, at 100-01.

In the *RCA* decision cited above, the taxpayer, RCA Corp., claimed that it purchased certain environmental control equipment (i.e., air conditioning equipment and air exchange equipment) to be directly used in the direct production of color television picture tubes, and, therefore, was exempt from sales/use tax. *Id.*, at 97-98. In making its case, RCA Corp. argued that the environmental control equipment was "**used to control the temperature, humidity and presence of foreign particles in the air**, in around and on the surfact [*sic*] of color television picture tubes during the manufacturing process." *Id.* (**Emphasis added**). The trial court agreed with the RCA Corp., but the Indiana Court of Appeals disagreed. Reversing the trial court's decision, the *RCA* Court ruled in favor of the Department. Applying the "double direct standard," the *RCA* Court found that:

Whatever effect (whether positive or negative) that RCA's air conditioning or environmental control equipment may have on the tubes RCA manufactures, or on the process of their manufacture, is exerted through the medium or agency of the environment (i.e., the air). The very name of the equipment, whether "air conditioning" or "environmental control", signifies that its immediate effect is on the surroundings in which the manufacturing process takes place and only remotely, through the intervening agency of those surroundings, on the tubes or on the process by which they are manufactured. *Id.* at 100.

The Court thus determined that RCA Corp. was not entitled to the manufacturing exemption for its purchase of the environmental control equipment/air conditioning equipment. Similarly, it would be presumed that a cleanroom environment, while practically necessary and essential in order to ensure that the product was created in a setting where humidity, temperature, particulate matter, and contamination are regulated, doesn't actually have an immediate effect on the article being produced. Like the matter in *RCA*, the cleanroom only has an immediate effect "on the surroundings in which the manufacturing process takes place." Thus, without further evidence from the taxpayer's customers explaining how the product lines would be used in an exempt manner pursuant to [IC 6-2.5-5-3](#), there is a presumption that the items that represent tangible personal property in the product lines would not be exempt.

With this presumption in mind, if a customer provides Contractor with an Indiana General Sales Tax Exemption Certificate (Form ST-105) or a Streamlined Sales and Use Tax Agreement (SSTGB Form F0003), it is Contractor's responsibility to ensure that their customer will be using their product lines in an exempt manner. If Contractor's customer can properly document in writing how the product lines will be used in an exempt manner, then with their customer's properly executed ST-105, Contractor is not required to collect Indiana sales or use tax. [IC § 6-2.5-8-8\(a\)](#). However, Contractor would need to retain such records for at least three years pursuant to [IC 6-](#)

Similarly, Contractor can provide their own ST-105 or SSTGB Form F0003 to their vendors (not their customer's exemption certificates) in order to purchase any items under the sale for resale exemption ([IC 6-2.5-5-8](#)) as long as they are operating under a time and material contract. If they are not operating under a time and material contract, then they are not purchasing the construction material for resale and cannot use ST-105 or SSTGB Form F0003 for that purpose. Further, a contractor can purchase materials exempt from sales tax "if the ultimate purchaser or recipient" of construction material were exempt from Indiana sales tax if that purchaser had directly purchased the construction material themselves, which is an exemption that would apply regardless of whether a contractor was operating under a time and material contract or not. IC § 6-2.5-4-9(c). However, with the presumption that Contractor's customers would not be able to use the product lines in an exempt manner, Contractor would first need to obtain the required documentation described in the paragraph above before claiming this exemption on an ST-105.

Finally, regarding pre-construction design services, services are generally not subject to Indiana sales tax. [45 IAC 2.2-4-2](#). If performed as part of a time and material contract, it would be part of the nontaxable "time" or labor part of the contract. If performed as part of a non-time and material contract, there is no retail transaction, so sales tax would not be charged to the customer anyway. If the services are charged as a stand-alone service in a separate invoice or contract, then the service would be presumed to be nontaxable as long as no tangible personal property is conferred as part of the service.

### **RULING**

Contractor's product lines are subject to Indiana sales tax when Contractor purchases the materials if Contractor is not operating under a time and material contract, but if it is operating under a time and material contract, Contractor would collect sales tax on the billings to their customers. This is true regardless of whether Contractor works as a subcontractor or directly for the project owner; however, the tax consequences for the prime contractor would depend on what type of contract they are operating under with the project owner.

Contractor's product lines would be presumed to not qualify for the manufacturing exemption under [IC 6-2.5-5-3](#). However, if Contractor does receive written documentation from its customer properly explaining how the product lines would qualify, Contractor may sell the product lines exempt from Indiana sales tax if the documentation is accompanied by a properly executed exemption certificate (Form ST-105 or STGB Form F0003). Contractor must keep such records for at least three years.

Contractor would need to provide a properly executed exemption certificate (Form ST-105 or STGB Form F0003) to their vendors to purchase materials exempt from sales tax under the sale for resale exemption when they operate under a time and material contract. It may not be used when they operate under a lump sum or other non-time and material contract.

Finally, pre-construction design services are not subject to sales tax if part of a construction contract, and if a standalone charge, then they are not subject to sales tax to the extent that no tangible personal property is also conferred as part of the charge.

### **CAVEAT**

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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