

DEPARTMENT OF STATE REVENUE

Revenue Ruling # 2022-06ST
April 12, 2023

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ISSUES

Sales and Use Tax - Clean Rooms

Authority: [IC 6-2.5-2-1](#); [IC 6-2.5-3-1](#); [IC 6-2.5-3-2](#); [IC 6-2.5-5-3](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10](#); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988).

A taxpayer ("the Company") is seeking a determination regarding the application of the sales tax exemption for manufacturing and production as it applies to certain purchases for use in a clean room environment at its new manufacturing facility.

STATEMENT OF FACTS

The Company is a manufacturer and wholesaler of glass primary packaging for the pharmaceutical industry. The Company is currently constructing a manufacturing facility in Indiana. The Company provides the following information regarding the transactions at issue, reproduced exactly as submitted in its request for a ruling with certain details redacted:

The Company specializes in the production of glass primary packaging for pharmaceutical use, such as cartridges for insulin pen injectors, glass vials, prefilled syringes, and other specialized containment solutions. Their products include vials, cartridges, and syringes that meet strict international sterilization standards for use in pharmaceutical delivery. The Company works with biopharma companies and device manufacturers in the selection of the most appropriate packaging components, providing fully integrated systems to enhance drug quality, safety and efficacy, as well as operational efficiency and patients' health.

Due to strict sterilization requirements, the Company's products must be manufactured to be free of detectable contamination. Maintenance of manufacturing conditions that minimize the risk of contamination to Company's products is critical. A clean room environment is required during the manufacturing process. The clean rooms are separate and self-contained areas in which the manufacturing process occurs.

The Company's clean room and the equipment therein will be used to create a specific manufacturing environment required for the manufacture of Company's products. The Company's products are highly susceptible, throughout the manufacturing process, to airborne contaminants and to variations in temperature and humidity. Although the clean room equipment does not itself come into actual physical contact with the items the Company produces, the equipment nonetheless is absolutely essential to the production process and has an immediate effect upon the article being produced. Without the sterile and controlled air environment created by clean room equipment, it is impossible to manufacture the Company's products.

The Company has entered into several lump-sum contracts with contractors for the construction of the manufacturing facility. The Company recognizes that generally, all sales to construction contractors of tangible personal property, including sales of construction materials, are subject to Indiana sales tax, paid by the contractor. The conversion of construction materials into real property does not alter this general rule with respect to the taxes imposed on the purchaser's acquisition or use of that material. Thus, absent an exemption, all construction material purchased by a contractor is taxable at the time the material is purchased, or, if acquired exempt, upon disposition. Contractors purchasing construction material are generally liable for paying the tax to the supplier at the time the material is purchased. Some of the materials purchased by the contractors will be incorporated into specific clean room areas of the manufacturing facility, including environmental control equipment, flooring, ducts, etc. A clean room itself, upon completion, serves as a controlled manufacturing environment for the production of medical devices that are highly susceptible to contaminants.

The following categories of items will be used in the clean room environment, followed by Company's estimated tax-exempt percentages:

Description	Tax exemption
Chillers	91%
Air Handling Unit ("AHU") (Dual Duct)	100%
AHU Core & Shell (in process areas)	100%
Air compressors	100%
Cooling towers	92%
Condensing boilers	96%

DISCUSSION

The Company requests the Department to issue a Ruling regarding the application of sales and use tax for the purchases of the property that will be used to construct the Company's clean room. Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. [IC 6-2.5-2-1\(a\)](#). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. [IC 6-2.5-2-1\(b\)](#). Indiana also imposes a complementary use tax on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." [IC 6-2.5-3-2\(a\)](#). "Use" means the "exercise of any right or power of ownership over tangible personal property." [IC 6-2.5-3-1\(a\)](#). In general, all purchases of tangible personal property are subject to sales and/or use tax unless an enumerated exemption from sales and/or use tax is available.

In applying any tax exemption, the general rule in Indiana is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here 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 100-101.

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). However, [IC 6-2.5-5-3](#) provides an exemption for manufacturing machinery, tools, and equipment in pertinent part as follows:

(b) Except as provided in subsection (d), transactions involving manufacturing machinery, tools, and equipment, including material handling equipment purchased for the purpose of transporting materials into activities described in this subsection from an onsite location, are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

More context on the exemption at [IC 6-2.5-5-3](#) is provided by 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." The integrated production process for manufacturers starts once work-in-process materials are transported into the manufacturing process and ends after the product is packaged for sale. [45 IAC 2.2-5-8\(c\)](#), example 1.

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(A) Air compressors used as a power source for exempt tools and machinery in the production process.

(B) An electrical distribution system, including generators, transformers, electrical switchgear, cables inside or outside the plant, and related equipment used to produce and/or supply electricity to exempt manufacturing equipment used in direct production.

(C) A pulverizer for raw materials to be used in an exempt furnace to produce and/or supply energy to manufacturing equipment used in direct production.

(D) Boilers, including related equipment such as pumps, piping systems, etc., which draw water, or

produce and transmit steam to operate exempt machinery and equipment used in direct production.

(E) A work bench used in conjunction with a work station or which supports production machinery within the production process.

(F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

(G) An automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry.

(3) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.

(A) Pumping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.

(B) Cooling towers and related pumps and piping used to cool, circulate, and supply water employed to control the temperature of exempt furnaces and exempt machines used in the foundry and machining areas.

...

(Emphasis added).

Further, [45 IAC 2.2-5-8\(g\)](#) provides a detailed explanation of what it means for equipment to have an immediate effect upon the article being produced:

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.

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product.

[45 IAC 2.2-5-8\(e\)](#) provides that "storage equipment" is treated as follows:

Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

(1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.

(2) Storage containers for finished goods after completion of the production process are subject to tax.

(3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

Whether the manufacturing sales and use tax exemption at [IC 6-2.5-5-3](#) is applicable to a controlled manufacturing environment was at issue in *RCA Corp.* The taxpayer, RCA Corp., claimed that it purchased certain environmental control equipment (i.e., air conditioning equipment) to be directly used in the direct production of color television picture tubes, and, therefore, was exempt from sales/use tax. *RCA Corp.*, 310 N.E.2d at 97-98. The trial court agreed with the RCA Corp. However, upon appeal, the appeals court concluded 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., 100. The taxpayer was not entitled to the manufacturing exemption for its purchase of the environmental control equipment/air conditioning equipment.

In *Kimball*, the Indiana Court of Appeals found that that Kimball International, a piano manufacturer, met its burden of proof and was entitled to manufacturing exemption on its purchases of spray booths, air make up units, and the associated component parts. In relevant part, the court stated:

It was also uncontroverted that the combination of the air make up units and the spray booths creates an airflow that is essential to the manufacturing process. This air movement promotes drying of the newly applied finish. Without this predrying a condition called "blistering" would occur during the later oven drying stage whereby trapped solvents would create bubbles in the finish. The airflow is also responsible for controlling sags and runs in the newly applied finish by improving the uniformity of the spray.

Kimball, 520 N.E.2d 454, 455.

In a Letter of Findings, the Department concluded that the taxpayer was not entitled to the sales tax exemption on HVAC system for use in its manufacturing facility. Letter of Findings 04-20110100 ([20111026-IR-045110644NRA](#)). The Department stated:

Thus, unlike the taxpayer's use of spray booths and air make up units in *Kimball* to prevent "blushing" and "blistering" in producing the saleable products, Taxpayer's use of the HVAC system, though arguably necessary, did not have a direct and/or an immediate impact on the engines it manufacturers/assembles. Rather, Taxpayer's use of the HVAC system is more like the taxpayer in *RCA*—to control the temperature inside its Indiana facility, which, in turns, reduce the claimed temperature fluctuation in order to achieve its desired CPKs. As [45 IAC 2.2-5-8\(g\)](#) explains "[t]he 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.'" Rather, "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." *Id.* Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer has met its burden. Pursuant to Indiana statutes, regulations, and case law, Taxpayer thus is not entitled to the manufacturing exemption.

The Company requests a Revenue Ruling on the application of sales tax on materials and equipment that are incorporated into a clean room at their new manufacturing facility. Only the materials and equipment that are essential for creating the clean room manufacturing environment that is required to conduct the business of manufacturing the Company's products are at issue. The Company acknowledges that the manufacturing exemption does not apply to any materials and equipment that are also used in other parts of the manufacturing facility. For example, the Company recognizes that the HVAC that is installed for use to control the overall temperature of the building, including general areas and clean room areas, is not exempt from Indiana sales tax.

The Company believes that its clean room meets the criteria of the manufacturing sales tax exemption as allowed in [45 IAC 2.2-5-8](#). The Company asserts that the particular property is considered essential for its manufacturing process and that it has "has an immediate effect upon the article being produced." The clean room is an integral part of an integrated process which produces tangible personal property.

Company states that many of the purchased items in the categories listed in the table above are used in the facility's cleanroom environment. However, some are installed in administrative areas of the facility. Some of the items, specifically the AHU's, become real property upon installation. Company has examined where the property is located in the facility and its use as an "essential and integral part of the integrated production process." Company proposes that using electrical consumption for each category should be a valid indicator of use in the manufacturing environment. Company believes that there is an obvious correlation between electrical consumption and time when analyzing the "directly used" criteria of the manufacturing exemption.

The Department has held in the past that if the nature of the manufactured product requires that a stage of the production process occur in a dust-free, particle-free environment in order to produce a saleable product, rather than to maintain the environment, then equipment, materials and supplies used to maintain a clean room can be exempt pursuant to [IC 6-2.5-5-3](#). See Letter of Findings 04-867862. However, as with all matters concerning the exemption at [IC 6-2.5-5-3](#), the determination as to whether equipment, materials and supplies used to maintain a

clean room are directly used in direct manufacturing or production is necessarily a fact-specific inquiry.

Because the nature of the items that Company's produces need to meet strict sterilization standards, production needs to be made in an environment that neutralizes the risk of contamination. Based on this information and other factors presented by the Company, the Department agrees that machinery and equipment that are incorporated into a clean room at the Company's manufacturing facility are essential and integral part of an integrated process which produces their vials, cartridges, and syringes, and are therefore exempt from sales tax. Such machinery and equipment would be exempt to the extent that Company has determined its usage in the clean room environment. However, the figures would be subject to review in the event of an audit.

However, construction materials that do not fall within the category of machinery, tools, or equipment are not eligible for exemption, as [IC 6-2.5-5-3](#) only pertains to machinery, tools, and equipment. Thus, flooring, ductwork, and other construction materials that are not machinery, tools, or equipment that are incorporated into real property would not be exempt.

RULING

The machinery and equipment that are incorporated the Company's clean room within their manufacturing facility exempt from sales tax because they are directly used in direct production of Company's products pursuant to [IC 6-2.5-5-3](#). However, flooring, ductwork, and other construction materials incorporated into real property would not be exempt, because they are not machinery, tools, or equipment.

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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