

# ADDRESSING THE CRITICISM ON FLAGS OF CONVENIENCE: SHOULD FLAGS OF CONVENIENCE BE ABOLISHED FOR THE CRUISE INDUSTRY?

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## I. INTRODUCTION

Cruise companies, which have experienced phenomenal growth in the last decade, widely employ flags of convenience.<sup>1</sup> This traditional maritime

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1. Joseph V. Micallef, *State of the Cruise Industry: Smooth Sailing into the 2020's*, FORBES (Jan. 20, 2020, 11:37 AM), <https://www.forbes.com/sites/joemicallef/2020/01/20/state-of-the-cruise-industry-smooth-sailing-into-the-2020s/?sh=270e274f65fa>.

According to the Cruise Lines International Association (CLIA), the world’s largest cruise industry trade organization, 32 million passengers were set to travel on cruise ships in 2020, up from 30 million in 2019. However, this growth came to an abrupt stop due

business practice has relied on developing states while lowering safety standards and generating environmental costs. Flags of convenience and open registries allow large cruise lines to pay little or no taxes in the countries where they are headquartered and conduct business. This note seeks to shed light on the issues surrounding flags of convenience and open registries and further advocates for the recognition of a “patron created value” and international uniformity in setting standards to address it.

Flags of convenience and open registries have allowed cruise companies to utilize century-old U.S. tax rules to avoid paying corporate taxes.<sup>2</sup> Cruise lines are evading taxes in other developed countries because the major cruise lines, and their parent corporations, are headquartered in the United States. Offshore registration allows the cruise lines to use Internal Revenue Code (IRC) Section 883, which exempts income earned by foreign corporations for the “international operation of a ship or ships,” as long as their country of residence also extends the same protection to U.S. ships.<sup>3</sup> The term offshore refers to a location outside of one’s national boundaries. For example, cruise lines incorporated in the United States register their ships internationally. These strategies give cruise companies the ability to shift their profits from high-tax jurisdictions that strictly enforce safety and labor regulations to low-tax jurisdictions with often weakly enforced safety and labor regulations.<sup>4</sup> Essentially, cruise lines such as Carnival Cruise Line keep its headquarters in a high-tax jurisdiction, like the United States, but register its vessels in a country like Panama, which does not tax companies for foreign-source income.<sup>5</sup> Effectively, cruise lines can make large profits while paying virtually no taxes in the jurisdiction that they are headquartered in and operate from.

Every year, flags of convenience and open registries cost the United States hundreds of millions of dollars in lost revenue. Major U.S. cruise lines, like Carnival Cruise Line, would have owed around \$600 million in corporate taxes on its reported \$3 billion income in 2019.<sup>6</sup> Furthermore, the parent corporations of cruise lines pay significantly low taxes too. For example, in

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to the COVID-19 outbreak. Since 2009, cruise ship passengers have grown from 17.8 million to 30 million, an annual growth rate of 5.4%.

*Id.*

2. See 26 U.S.C. § 883(a)(1) (2018).

3. *Id.*

4. See Ved P. Nanda, *U.S. Perspective on the Legal Aspects of Cruises*, 66 AM. J. COMP. L. 213, 214 (2018).

5. *Id.*

6. Leticia Miranda, *Most Cruise Lines Don’t Pay Federal Income Tax — Just One of the Reasons They Aren’t Getting a Bailout*, NBC NEWS (Mar. 31, 2020, 3:57 AM), <https://www.nbcnews.com/business/business-news/most-cruise-lines-don-t-pay-taxes-u-s-just-n1172496>.

2019, Carnival Corporation paid an income tax of \$71 million on \$20.83 billion in revenue; Royal Caribbean Group, which registers its fleet in Liberia, paid \$36.2 million in taxes on \$10.95 billion in revenue; and Norwegian Cruise Line Holdings, which registers its ships in Bermuda, actually showed a tax benefit of \$18.86 million on \$6.46 billion in revenue.<sup>7</sup> Cruise lines can do this because their cruise ships are registered in countries that have little to no corporate taxes. Notably, with the use of technology, corporations can easily register a ship in a foreign country. For example, Panama has a beneficial open registry system that offers non-nationals a quick and easy online registration process for ships.<sup>8</sup>

Critics of flags of convenience and open registries, like trade unions, governments, and international organizations, agree that flags of convenience and open registries are a problem, but so far have been unable to bring about a uniform solution. As of 2020, 173 member states of the United Nations are Member States of the International Maritime Organization (IMO), whose mission is to promote safe, secure, environmentally sound, efficient, and sustainable shipping through cooperation.<sup>9</sup> However, although the IMO makes international rules that govern the industry, it lacks enforcement power. Additionally, although the United Nations Convention on the Law of the Sea (UNCLOS)<sup>10</sup> provides that port states have the power to enforce their laws and regulations that conform with international law, it also provides that once a vessel is twenty-four miles away from any coastline, it is considered to be on international waters and the nation of its registry has exclusive jurisdiction over that vessel.<sup>11</sup> The flag state, the country whose flag a vessel is registered under, is responsible for inspecting the vessel and its seaworthiness, safety, pollution prevention, and crew certification.<sup>12</sup> Enforcing international rules that govern the cruise industry is left to these countries where cruise ships are registered and whose economies often depend on tourism dollars. Panama, Bahamas, Bermuda, Malta, the Marshall Islands, and Liberia are a non-exhaustive list of countries whose economies depend on tourism and revenue from vessel registration fees. These countries

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7. Jonathan Wolfe, *Cruise Lines Were Shut Out of the Stimulus. Here's Why.*, N.Y. TIMES (Apr. 8, 2020), <https://www.nytimes.com/2020/04/08/travel/cruises-coronavirus-stimulus.html>.

8. *Why So Many Shipowners Find Panama's Flag Convenient*, BBC NEWS (Aug. 5, 2014) <https://www.bbc.com/news/world-latin-america-28558480>.

9. International Maritime Organization Res. 1110(30), Strategic Plan for the Organization (Dec. 8, 2017).

10. United Nations Convention on the Law of the Sea, Dec. 10, 1982, 1833 U.N.T.S. 397 [hereinafter UNCLOS].

11. *Id.* arts. 3, 92.

12. *Flags of Convenience*, NGO SHIPBREAKING PLATFORM, <https://shipbreakingplatform.org/issues-of-interest/focs/> (last visited Sept. 2, 2021).

are lax in enforcing international maritime laws, fearing that it will make them less competitive as low-tax and lax enforcement havens for cruise companies.<sup>13</sup>

Frustrated with cruise lines turning profits while “running roughshod over U.S. laws and values,”<sup>14</sup> on April 24, 2020, Congresswomen Doris Matsui and Jackie Speier introduced legislation in the U.S. House of Representatives limiting federal assistance for cruise industry companies that fail to undertake significant tax, environmental, medical, and labor reforms.<sup>15</sup> The Cruise Reform and Uniform Industry Standards Evoke Integrity Act (CRUISE Integrity Act) addresses the industry’s abysmal history of negligence and evasion by requiring companies to incorporate and register vessels in the United States and adhere to strict standards to be eligible for federal aid.<sup>16</sup> However, federal bills like the CRUISE Integrity Act rarely gain traction because of the cruise industry’s intensive counter-lobbying efforts in the U.S. Congress. For example, the cruise industry spent \$3.2 million on lobbying within the first nine months of 2020.<sup>17</sup> The CRUISE Integrity Act would prohibit cruise lines from receiving federal funds and federal assistance unless such cruise lines have at least fifty percent of vessels registered in the United States,<sup>18</sup> a requirement that no cruise line currently meets.

Cruise lines can avoid paying high corporate taxes in their home countries and are often responsible for environmental and safety disasters. However, this note argues that ending flags of convenience goes too far. The cruise industry is a dominant player in the global tourism sector. Cruise lines also play an important role in the economies of many developing countries. However, despite the cruise industry’s phenomenal growth and contribution to the global tourism sector, the cruise industry was crippled by the COVID-19 outbreak in 2020 when the U.S. Centers for Disease Control and

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13. *Flags of Convenience*, INT’L TRANSP. WORKERS’ FED’N, <https://www.itfglobal.org/en/sector/seafarers/flags-of-convenience> (last visited Sept. 2, 2021).

14. Press Release, Jackie Speier, Congresswoman, House of Representatives, Reps Speier and Matsui Introduce Bill to Crackdown on the Cruise Lines’ Tax Evasion, Environmental, and Labor Violations (Apr. 27, 2020), <https://speier.house.gov/2020/4/rep-speier-and-matsui-introduce-bill-to-crackdown-on-cruise-lines-tax-evasion-environmental-and-labor-violations>.

15. Cruise Reform and Uniform Industry Standards Evoke Integrity Act, H.R. 6625, 116th Cong. (2019-2020).

16. *Id.*

17. Michael Smith, *Cruise Lines Lobby Trump’s White House to End No-Sail Order*, BLOOMBERG (Oct. 29, 2020) <https://www.bloomberg.com/news/articles/2020-10-29/cruise-lines-lobby-trump-s-white-house-to-end-no-sail-order>.

18. H.R. 6625, § 2(a)(2).

Prevention (CDC) issued a temporary “No Sail Order,” a circumstance that may heighten the stakes of reforming regulations in the industry.<sup>19</sup>

One standard that deserves further research to resolve issues with flags of convenience is an international convention, perhaps with the IMO, to create a uniform tax policy on cruise line revenue based on the number of a nation’s residents that patronize a cruise line for example. As the cruise industry continues to experience dynamic growth, a uniform tax policy will require the cruise companies to pay their fair share in corporate taxes and follow international maritime laws. Money collected from this tax can be invested in preserving the environment and ensuring the safety of the crew at sea. Prior to exploring various resolutions regarding the taxation issue, Section II first discusses the history of flags of convenience and how this traditional maritime business practice has allowed the cruise industry to drastically grow in the last century. Section III addresses the oversight and jurisdiction issues of the cruise industry and how flag states fail to enforce international maritime laws to vessels registered under their flags. Section IV discusses how the tax should be implemented by the Member States of the IMO and how money collected from this tax can allow cruise companies to continue operating profitably while in the public interest. Finally, section V will conclude by responding to the critics of flags of convenience and open registries by analyzing the importance of keeping the cruise industry afloat.

## II. HISTORY OF FLAGS OF CONVENIENCE

The modern use of flags of convenience can be traced back to the 1920s, when shipowners flagged or reflagged their vessels to avoid Prohibition laws in the United States.<sup>20</sup> During that time, several U.S. vessels, including two cruise liners, the *M/V Reliance* and the *M/V Resolute*, were reflagged in Panama to avoid the U.S. law banning the sale of alcohol aboard ships registered in the United States.<sup>21</sup> This new business model soon became a trend in the 1950s, diminishing the size of the U.S. flag fleet. While once considered the world’s largest privately-owned merchant marine fleet, U.S. flag vessels became almost non-existent in the ocean trades.<sup>22</sup> Commercial shipping soon followed the trend of flying flags of convenience.<sup>23</sup>

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19. Frances Robles, *Extending Cruise Ban, C.D.C. Slams Industry for Spreading Coronavirus*, N.Y. TIMES (July 16, 2020) <https://www.nytimes.com/2020/07/16/travel/coronavirus-cruise-ban-extended.html>.

20. See N.P. READY, SHIP REGISTRATION 25-26 (1991).

21. H. Edwin Anderson III, *The Nationality of Ships and Flags of Convenience: Economics, Politics, and Alternatives*, 21 TUL. MAR. L.J. 139, 156 (1996).

22. *Id.* at 156-57.

23. *Id.* at 157.

During its early conception, the term “flag of convenience” was synonymous with shipowners using open registration tactics for political reasons or to conceal criminal or questionable activities.<sup>24</sup> Today, however, the term has evolved to represent a modern maritime business practice to circumvent developed countries’ labor and tax regulations through foreign registration.<sup>25</sup> The Rochdale Report of 1970, published by the United Kingdom, lists the following six criteria that identify whether a ship is registered under a “flag of convenience”:<sup>26</sup>

(1) The country of registry allows ownership and/or control of its merchant vessels by non-citizens;<sup>27</sup>

(2) Access to the registry is easy; ship may usually be registered at a consulate abroad. Equally important, transfer from the registry at the owner’s option is not restricted;<sup>28</sup>

(3) Taxes on the income from the ships are not levied locally or are very low. A registry fee and an annual fee, based on tonnage, are normally the only charges made. A guarantee or acceptable understanding regarding future freedom from taxation may also be given;<sup>29</sup>

(4) The country of registry is a small nation with lax regulation for all the shipping registered, but the nation’s receipts from small charges on a large tonnage may produce a substantial effect on its national income and balance of payments;<sup>30</sup>

(5) Manning of ships by non-nationals is freely permitted; and<sup>31</sup>

(6) The country of registry has neither the power nor the administrative machinery effectively to impose any governmental or international regulations; nor has the country even the wish or the power to control the companies themselves.<sup>32</sup>

The Rochdale Report makes it clear that most open registry countries are developing states that do business with shipowners from developed countries. Moreover, the Rochdale Report also highlights the possibility of

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24. *Id.*

25. William R. Gregory, *Flags of Convenience: The Development of Open Registries in the Global Maritime Business and Implications for Modern Seafarers* (Nov. 1, 2012) (M.A. thesis, Georgetown University) (on file with author).

26. RT. HON. THE VISCOUNT ROCHDALE, COMMITTEE OF INQUIRY INTO SHIPPING: REPORT ¶ 184 (1970) (defining Flags of Convenience and providing the primary source for defining Flags of Convenience) [hereinafter ROCHDALE REPORT].

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

shipowners from developed countries exploiting developing countries by registering their vessels under foreign flags while knowing that developing countries lack the resources and financial ability to inspect ships to enforce governmental or international regulations. In this context, the creation of open registries has led to numerous environmental and safety disasters in the maritime industry due to the lack of inspections and enforcement of existing international maritime laws.

### III. OVERSIGHT AND JURISDICTION

National and international laws governing the maritime industry are extensive and variable. As a result, cruise ships are subject to robust layers of concurrent jurisdictions from port and flag states. The United Nations Convention on the Law of the Sea remains an important source of international law that outlines port state jurisdiction over ships on the high seas. UNCLOS provides that port states have the power to enforce their laws and regulations that are in conformity with international law, on ships that are flagged under foreign countries.<sup>33</sup> However, UNCLOS also provides that for a ship to engage in international commerce and operate in international waters, it must be registered in a country and it shall be subject to that country's exclusive jurisdiction on the high seas.<sup>34</sup> Thus, once a cruise ship is in the high seas, otherwise known as international waters, it is only subject to its flag state's jurisdiction.

#### A. *Maritime Regulations Should Treat All Cruise Lines Equally, Regardless of Flag Registry*

The existing robust layers of maritime laws regulating the cruise industry should prevent disasters by treating all cruise lines equally, regardless of flag registry. The most notable example of the maritime industry enhancing passenger and crew safety on board a cruise ship after a disaster is the *Costa Concordia* disaster<sup>35</sup> that took place on January 13, 2012. After the *Costa Concordia* struck a rock in the Tyrrhenian Sea and capsized, leaving thirty-two people dead, the Cruise Lines International Association

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33. UNCLOS, *supra* note 10, art. 3 ("Every State has the right to establish the breadth of its territorial sea up to limit not exceeding 12 nautical miles, measured from baselines determined in accordance with this Convention.").

34. *Id.* art. 94.

35. In that maritime disaster, the *Costa Concordia*, a cruise ship owned by Costa Cruises whose parent company is Carnival Corporation & plc, capsized and left thirty-two people dead. Amy Tikkanen, *Costa Concordia Disaster*, BRITANNICA (Jan. 13, 2012), <https://www.britannica.com/event/Costa-Concordia-disaster>.

(CLIA), the European Cruise Council (ECC), and the Passenger Shipping Association (PSA) adopted a new policy that required all embarking passengers to participate in muster drills<sup>36</sup> before sailing. Additionally, Carnival Corporation, the parent company of Costa Cruises, now requires all the brands in its extensive portfolio to conduct muster drills before sailing.<sup>37</sup>

Changing the timing of muster drills is just one of the cruise industry's many adaptations to regulations and protocols that were prompted by a disaster. Cruise industry regulations and protocols should not be afterthoughts of a disaster, instead they should be preventative measures. Passenger and crew safety is one of the countless issues that exist in the cruise industry today. Critics of flags of convenience highlight other issues too, like cruise lines escaping responsibility from environmental disasters.

Some of the largest critics of flags of convenience are environmental groups that believe the cruise industry has a legacy of polluting the oceans.<sup>38</sup> International environmental organizations, like Friends of the Earth, argue the cruise industry's business practices have put the environment, climate, and public health of coastal communities, passengers, crew, and coastal and marine ecosystems at risk.<sup>39</sup> Although the cruise industry is touting its implementing of preventative measures in pollution, all Carnival Corporation companies committed criminal environmental violations between 2017 and 2019.<sup>40</sup>

The largest criminal environmental fines ever levied in the United States for deliberate pollution have been levied against the cruise industry.<sup>41</sup> For example, the U.S. Coast Guard conducted an examination of the *Caribbean Princess* on September 14, 2013, during which certain crew members

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36. A muster drill is a mandatory safety exercise with the objective to familiarize all passengers and the crew with the location (i.e., the muster station) where they are to assemble in the event of an emergency. *What Is a Muster Drill (Safety Briefing) on a Royal Caribbean Cruise Ship?*, ROYAL CARIBBEAN, <https://www.royalcaribbean.com/faq/questions/muster-drill-onboard-safety> (last visited Apr. 11, 2022).

37. "According to SOLAS . . . Chapter III, Regulations 19.2.2 and 19.2.3, whenever new passengers embark, a passenger Safety Briefing shall be given immediately before sailing or immediately after sailing. Passengers shall be instructed in the use of the lifejackets and the action to take in an emergency." *Safety Briefing—Muster Station Drill*, CARNIVAL, [https://help.carnival.com/app/answers/detail/a\\_id/1200/~safety-briefing---muster-station-drill](https://help.carnival.com/app/answers/detail/a_id/1200/~safety-briefing---muster-station-drill) (last visited Nov. 10, 2020).

38. *See generally* LINDA NOWLAN & INES KWAN, CRUISE CONTROL – REGULATING CRUISE SHIP POLLUTION ON THE PACIFIC COAST OF CANADA 28 (2001) (citing Bluewater Network's estimate that cruise ships are responsible for 77% of maritime pollution).

39. *Cruise Ship Record Card*, FRIENDS OF THE EARTH, <https://foe.org/cruise-report-card/> (last visited Sept. 3, 2021).

40. *Id.*

41. *See* Judgment in a Criminal Case, United States v. Princess Cruise Lines, Ltd., No. 16-20897 (S.D. Fla. Apr. 19, 2017), ECF No. 30.

continued to lie in accordance with orders they received from Princess Cruise Lines supervisors.<sup>42</sup> According to papers filed in court, the *Caribbean Princess* had been making illegal discharges of oil-contaminated bilge waste around the U.S. waters.<sup>43</sup>

However, just like changing the requirement of when to perform muster drills after the Costa Concordia disaster, the cruise industry is now taking an active role in environmental stewardship with the genuine commitment of the industry. Cruise companies are now voluntarily installing and retrofitting ships with state-of-the-art<sup>44</sup> pollution control technologies.<sup>45</sup> The adoption of more advanced pollution control technologies allows cruise lines to help preserve the environment. For example, Carnival Corporation's AIDA Cruises made history in 2018 with the launch of *AIDAnova* as the first cruise ship in the world that powered by lithium natural gas (LNG) both at sea and in port.<sup>46</sup> LNG-powered ships are not only less harmful to the environment but are also beneficial to cruise lines. Using LNG helps cruise lines emit cleaner discharge while also causing less wear and tear on the engine, thus simultaneously helping the environment and costing the cruise lines less money for maintenance.<sup>47</sup> Since Carnival's first major step in creating LNG-powered ships, other cruise lines like MSC Cruises, Disney Cruise Line, and Royal Caribbean have also ordered LNG-powered ships for their own fleets.<sup>48</sup> However, as seen with the *Caribbean Princess*, cruise line companies are not always transparent about their environmental practices, no matter the steps they take in their environmental stewardship.<sup>49</sup>

Installing advanced pollution controlling technologies is only one small step in the right direction; more extensive action is needed. After reaching a

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42. See Plea Agreement in a Criminal Case, *United States v. Princess Cruise Lines, Ltd.*, No. 16-20897 (S.D. Fla. Dec. 1, 2016), ECF No. 2.

43. See Joint Factual Statement, *United States v. Princess Cruise Lines, Ltd.*, No. 16-20897 (S.D. Fla. Dec. 1, 2016), ECF No. 2-1.

44. *Environmental Stewardship*, CRUISE LINES INT'L ASS'N, <https://cruising.org/en/about-the-industry/policy-priorities/environmental-stewardship> (last visited Nov. 11, 2020) ("Cruise lines work with scientists and engineers to develop cutting edge, sustainable environmental innovations and practices, investing \$1 billion in new technologies and cleaner fuels.").

45. Asia N. Wright, *Beyond the Sea and Spector: Reconciling Port and Flag State Control over Cruise Ship Onboard Environmental Procedures and Policies*, 18 DUKE ENV'T L. & POL'Y F. 215, 237 (2007).

46. *Pioneering Liquefied Natural Gas*, CARNIVAL CORP. & PLC, <https://carnivalsustainability.com/pioneering-lng> (last visited Nov. 8, 2020).

47. *Why More LNG-Powered Cruise Ships are Being Built*, HELLENIC SHIPPING NEWS WORLDWIDE (July 24, 2019), <https://www.hellenicshippingnews.com/why-more-lng-powered-cruise-ships-are-being-built/>.

48. *Id.*

49. Kate Wheeling, *How Cruise Ships Are Polluting Our Oceans*, PAC. STANDARD (Dec. 7, 2016), <https://psmag.com/news/how-cruise-ships-are-polluting-our-oceans>.

settlement with federal prosecutors to pay a \$20 million penalty for violating a pollution probation, Carnival Corporation's CEO, Arnold Donald, admitted that there are gaps in how the world's largest cruise ship operator followed environmental rules.<sup>50</sup> After admitting to the pollution probation violations, Carnival created a "chief ethics and compliance" officer job and enhanced its Code of Business Conduct and Ethics by developing a Business Partner Code of Conduct & Ethics that focuses on the following key interests: business integrity; protecting the environment; respecting labor and human rights; complying with health, safety and security protocols; and reporting concerns.<sup>51</sup> If Carnival Corporation recognizes its "responsibility to provide industry leadership and to conduct [its] business as a responsible global citizen," then it should have no problem with a uniform international tax policy for the cruise industry so that no future gaps exist in following the existing international maritime laws for environmental sustainability.<sup>52</sup>

International organizations like Friends of the Earth argue for more transparency. In its 2020 Cruise Ship Report Card, Friends of the Earth graded, among other things, the level of transparency of eighteen major cruise lines and 193 cruise ships. On the Report Card, transparency is based on whether each cruise line responded with specificity to Friends of the Earth's 2020 requests for information regarding a cruise line's environmental practices.<sup>53</sup> Thirteen of the eighteen graded cruise lines received an "F" in transparency.<sup>54</sup> Thus, one must question whether there is genuine industry commitment to environmental stewardship and whether more needs to be done to enforce international laws regarding maritime pollution.

#### B. Regulation by Port States

According to international law, every cruise ship must abide by IMO regulations regardless of where it is flagged or where it visits. UNCLOS provides that when foreign vessels sail to port states, these vessels are subject to the laws of that country's jurisdiction when they are within the port state's

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50. Tom Hudson, *Carnival Corp. Boss: 'There Were Some Gaps' in Environmental Oversight*, WLRN (Aug. 26, 2019), <https://www.wlrn.org/show/the-sunshine-economy/2019-08-26/carnival-corp-boss-there-were-some-gaps-in-environmental-oversight>.

51. *Carnival Corporation Names Peter C. Anderson as Chief Ethics & Compliance Officer*, PR NEWswire (Aug. 12, 2019, 9:24 EST), <https://www.prnewswire.com/news-releases/carnival-corporation-names-peter-c-anderson-as-chief-ethics--compliance-officer-300899986.html>; *Ethics & Compliance, Leading Responsibly*, CARNIVAL CORP. & PLC, <https://www.carnivalcorp.com/leading-responsibly/ethics-and-compliance> (last visited Nov. 11, 2020).

52. *Id.*

53. FRIENDS OF THE EARTH, *supra* note 39.

54. *Id.*

territorial waters.<sup>55</sup> Thus, port states can enforce international and domestic laws and regulations to cruise ships when their ports are visited.

For example, the U.S. Coast Guard enforces the regulations set by the IMO and all other international and federal safety, security, and environmental regulations that govern the cruise industry, on every cruise ship that sails to and from the United States, regardless of registration.<sup>56</sup> Another example is that under the provision of MARPOL 73/78,<sup>57</sup> the United States can enforce direct action under the U.S. laws against foreign-flagged ships when pollution discharge incidents occur within the U.S. jurisdiction.<sup>58</sup> Cruise ships or crews that fail to meet regulatory standards in any area can face possible penalties ranging from substantial fines for noncompliance to prohibiting a vessel from leaving port.<sup>59</sup>

Many other nations around the globe where cruise ships sail, including the United Kingdom, European Union (EU), Australia, and Canada, to name a few, have similar oversight and comprehensive regulations for the cruise industry. In the EU, enforcement of the rights and obligations under the European Commission Regulation<sup>60</sup> relies mainly on the flag state and port state control, and the relevant systems available in the EU.<sup>61</sup> Thus, strict regulations in the industry require the average cruise ship to undergo dozens

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55. UNCLOS, *supra* note 10, art. 220(1).

56. Jim Hull & Tim Sullivan, *Lax Regulations of Cruise Lines is a Myth*, TRAVEL WKLY. (Oct. 6, 2013), <https://www.travelweekly.com/Articles/Lax-regulations-of-cruise-lines-is-a-myth>.

57. International Protocol of 1978 relating to the International Convention for the Prevention of Pollution from Ships, 1973, *opened for signature* June 1, 1978, 1340 U.N.T.S. 61. MARPOL 73/78 is short for International Convention for the Prevention of Pollution from Ships and is 73/78 short for the years 1973 and 1978. MARPOL 73/78 is one of the most important international maritime environmental conventions and was developed by the IMO with an objective to minimize pollution of the oceans and seas, including dumping and oil and air pollution. John R. Lethbridge, *MARPOL 73/78 (International Convention for the Prevention of Pollution from Ships)*, WORLD BANK (Apr. 1991), <https://documents1.worldbank.org/curated/en/860841468330898141/pdf/816070BRI0Infr00Box379840B00PUBLIC0.pdf>.

58. Hull & Sullivan, *supra* note 56.

59. *Id.*

60. Commission Regulation 392/2009, 2009 O.J. (L 131) 24 (EC). The Regulation on the liability of carriers of passengers by sea in the event of accidents lays down harmonized rules on liability and insurance for shipping companies and aims at an adequate level of compensation should an accident occur. This applies irrespective of the area of operation of the vessel, *see id.* ¶ 4, thus to all carriers engaging in international carriage, including between EU Member States, and certain types of domestic carriage, *id.* art. 2, (over five miles from the coastline). *See Safety of Passenger Ships*, EUR. COMM'N: MOBILITY & TRANSP., [https://ec.europa.eu/transport/modes/maritime/safety-and-environment/safety-passenger-ships\\_en](https://ec.europa.eu/transport/modes/maritime/safety-and-environment/safety-passenger-ships_en) (last visited Sept. 11, 2021).

61. EUR. COMM'N: MOBILITY & TRANSP., *supra* note 60.

of announced and unannounced safety inspections every year.<sup>62</sup> Cruise ship inspections involve the implementation of thousands of specific requirements set by the IMO and other authorities.<sup>63</sup> However, although developed countries have the resources and money to ensure that cruise lines follow the industry's top priorities when cruise ships sail to their ports, cruise lines continue to conduct business with developing countries where IMO requirements and other regulations are not heavily enforced.<sup>64</sup>

### C. Regulation by Classification Societies

Flag states license classification societies to classify and certify cruise ships based on their structure, design, and safety standards.<sup>65</sup> Classification societies are independent, non-governmental organizations in the maritime industry that conduct inspections on behalf of flag states, cruise lines, insurers, and other members of the community. These inspections help ensure that cruise ships comply with applicable standards and are managed responsibly.

Currently, there are more than fifty classification societies in the world and the thirteen largest marine classification societies are also members of the International Association of Classification Societies (IACS). After international statutory regulations are developed by member states of the IMO, IACS provides guidance and technical support by developing unified interpretations. Each IACS member society applies these interpretations. International maritime regulations that are developed by the IMO and the classification rule requirements are then codified in the International Convention for the Safety of Life at Sea (SOLAS), an international maritime treaty which sets minimum safety standards in construction, equipment, and operation of merchant ships.<sup>66</sup> The IMO considers SOLAS as “the most

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62. *Vessel Sanitation Program*, CTRS. FOR DISEASE CONTROL & PREVENTION, [https://www.cdc.gov/nceh/vsp/desc/about\\_inspections.htm](https://www.cdc.gov/nceh/vsp/desc/about_inspections.htm) (last visited Sept. 11, 2021).

63. *Cruise Industry Regulation*, CRUISE LINES INT'L ASS'N, <https://cruising.org/en/about-the-industry/policy-priorities/cruise-industry-regulation> (last visited Sept. 11, 2021).

64. Sarah Mervosh, *Carnival Cruises to Pay \$20 Million in Pollution and Cover-Up Case*, N.Y. TIMES (June 4, 2019) <https://www.nytimes.com/2019/06/04/business/carnival-cruise-pollution.html> (“[V]iolations included discharging plastic into waters in the Bahamas, falsifying records and interfering with court supervision of ships by sending in teams ahead of inspections to pre-empt environmental violations, according to the corporation’s agreement with the Justice Department.”).

65. Int’l Ass’n of Classification Soc’ys, *Classification Societies – Their Key Role*, <https://www.iacs.org.uk/media/3784/iacs-class-key-role.pdf> (last visited Sept. 11, 2021) [hereinafter *Classification Societies*].

66. International Convention for the Safety of Life at Sea, 1974, Nov. 1, 1974, 1184 U.N.T.S. 2 [hereinafter *SOLAS*].

important of all international treaties concerning the safety of merchant ships.”<sup>67</sup>

However, although IACS and its individual members help promote maritime safety and clean seas by verifying compliance with published standards,<sup>68</sup> classification societies do not remedy all the issues that arise from flags of convenience because classification societies focus on establishing and maintaining technical standards for the construction and operation of ships. But the classification certificates that are issued by classification societies are a good initial step into ensuring environmental stewardship and passenger and crew safety. Despite that important role classification societies play in the maritime industry; flag states remain responsible for inspecting cruise ships registered under their names and are for enforcing international laws.

#### *D. Regulation by Flag States*

Flag states have exclusive jurisdiction over vessels registered under their flags on the high seas to the extent provided by international law.<sup>69</sup> Traditionally, the flag state is responsible for ensuring compliance with national and international laws and regulations concerning marine pollution and the construction, maintenance, and crewing of the vessel. UNCLOS provides that flag states have a duty to maintain regular checks upon the seaworthiness of ships, to ensure that crews are properly qualified, to hold inquiries into shipping casualties, to effectively exercise jurisdiction and control over their ships, to maintain a register of ships, to take measures to ensure safety at sea with regard to the construction, equipment and seaworthiness of ships, the manning of ships, labor conditions and the use of signals, the maintenance of communication, and the prevention of collision.<sup>70</sup> It is apparent that the enumerated flag state responsibilities found in UNCLOS are non-exhaustive.<sup>71</sup>

If a flag state has exclusive jurisdiction over cruise ships in the high seas, then it is evident that it must also exercise its jurisdiction to enforce the

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67. *International Convention for the Safety of Life at Sea (SOLAS), 1974*, INT’L MAR. ORG., [https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-the-Safety-of-Life-at-Sea-\(SOLAS\)-1974.aspx](https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-the-Safety-of-Life-at-Sea-(SOLAS)-1974.aspx) (last visited Sept. 11, 2021).

68. Classification Societies, *supra* note 65.

69. UNCLOS, *supra* note 10, art. 92(1).

70. *Id.* art. 94.

71. *Id.*

binding international rules to which it is subject.<sup>72</sup> However, critics of flags of convenience argue that flag states insufficiently police and enforce regulations, like pollution, since statistics show foreign-flag states act upon less than two percent of pollution-dumping cases referred to them by the U.S. Department of State.<sup>73</sup> This major flaw in the cruise industry must change immediately.

The cruise industry's use of flags of convenience has become a business practice that largely benefits cruise lines. In return, cruise lines play an important role in a flag state's economy because the economy of most flag states is almost entirely dependent on tourism and financial services to generate foreign exchange earnings.<sup>74</sup> Developing states are attractive business partners for cruise lines because the labor cost for maintaining a vessel in the registry of a developed state is too high for shipowners.<sup>75</sup> High crewing and operating costs cause vessel owners to utilize a flag of convenience to receive larger profits and remain competitive.

Flags of convenience not only diminished maritime employment in developed countries but also created a dependency issue by exploiting developing states. As a result, this dependency causes the economic development of developing countries to be influenced heavily by outside investors, like cruise lines. This quid pro quo business model makes it difficult for developing states to enforce international maritime regulations on cruise ships registered under their flags. Many flag states cannot afford the resources needed to inspect cruise ships, and, as a result, the cruise industry is often involved in many of the environmental and safety disasters in the maritime industry.<sup>76</sup>

#### IV. ADDRESSING THE TAX LOOPHOLE WITH A NOVEL APPROACH

Members of Congress of the United States must recognize the need to adapt the current tax laws to the growing cruise industry. In introducing the CRUISE Integrity Act, Congresswoman Speier stated, "For too long, cruise

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72. Tamo Zwinge, *Duties of Flag States to Implement and Enforce International Standards and Regulations – And Measures to Counter Their Failure to Do So*, 10 J. INT'L BUS. & L. 297, 300 (2011).

73. Eric V. Hull, *Soiling the Sea: The Solution to Pollution is Still Dilution – A Re-Evaluation of the Efficacy of 40 C.F.R. § 122.3 and Annex IV of MARPOL*, 3 BARRY L. REV. 61, 68 (2002).

74. *About the Tourism Industry*, TOURISM TODAY, <https://www.tourismtoday.com/training-education/tourism-careers/about-industry> (last visited Nov. 7, 2020).

75. David Matlin, *Re-evaluating the Status of Flags of Convenience Under International Law*, 23 VAND. J. TRANSNAT'L L. 1017, 1050-51 (1991).

76. Bill Shaw et al., *The Global Environment: A Proposal to Eliminate Marine Oil Pollution*, 27 NAT. RESOURCES J. 157, 160-63 (1987).

lines have turned a profit while running roughshod over U.S. laws and values . . . all while incorporating abroad and using foreign-flagged ships to dodge U.S. taxes.”<sup>77</sup> As written, the bill seeks to establish requirements that are unnecessarily detrimental to the cruise industry, such as the requirement to “have at least 50% of vessels registered in the United States.” Requiring cruise lines to register their fleets in the United States is incredibly burdensome because the United States has the most stringent requirements of any maritime nation.<sup>78</sup> Rather than requiring cruise lines to register their fleets in the United States, where most major cruise lines are headquartered, member states of the IMO should work together to create a uniform tax policy for the cruise industry. This tax policy can be based on the number of a nation’s residents that patronize a cruise line. The money collected from this tax can be invested in preserving the environment and ensuring the safety of the crew at sea. Thus, this tax will help cruise lines to continue operating profitably and in the public interest at the same time.

A. *Flags of Convenience as a Quid Pro Quo Business Strategy*

The use of open registries is vital for the cruise industry, but more importantly, it is critical for the economies of many developing states. The use of flags of convenience has led to a socio-economic dependency of developing countries upon the developed world.<sup>79</sup> Strict registration requirements from developed countries, like the requirements outlined in the CRUISE Integrity Act, are a reason why cruise line companies seek to register their ships in foreign countries. Another example include trade unions in the United States, like the International Transport Workers’ Federation (ITF), who are responsible for the strict requirements regarding crewing a vessel.<sup>80</sup> Continuous lobbying from trade unions to push mandates that increase maritime employment has led to the opposite result of decreasing maritime employment in developed states.<sup>81</sup> The high labor costs of maintaining a cruise ship registered in a developed country, like the United States, is an unattractive business model to cruise line companies.

Cruise lines seek more attractive business models by choosing to register their ships in open registry countries. As a result, open registry countries obtain an income from maintaining the registries while the cruise line

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77. Press Release, Jackie Speier, *supra* note 14.

78. Anderson, *supra* note 21, at 151.

79. *Id.* at 158.

80. Herbert R. Northrup & Richard L. Rowan, *The International Transport Workers’ Federation and Flags of Convenience Shipping Campaign: 1983-1995*, 23 *TRANSP. L. J.* 369, 378 (1996).

81. *See id.* at 372-73.

companies increase profits. As highlighted in the Rochdale Report, cruise line companies from developed countries take advantage of developing countries by registering their vessels under foreign flags because they know that developing countries lack the resource and financial ability to inspect ships to enforce governmental or international regulations.<sup>82</sup>

The quid pro quo business strategy between cruise line companies and developing states seems like a good business model on its face for both entrepreneurs and open registry countries. However, the overall effect of open registries on the economies of developing states is negative.<sup>83</sup> Flags of convenience make it difficult for developing states to compete effectively, and cruise lines take advantage of the cheaper labor available in those countries.<sup>84</sup> Although the creation of open registries and their administration comes from developed countries, the movement to restrict the use of flags of convenience also comes directly from developed countries. Instead of tightening open registries, developed countries should work with the IMO to create a uniform international tax policy for the cruise industry.

#### B. “Patron Created Value” in the Cruise Industry

The cruise industry depends on passenger satisfaction because a good customer experience will create value. Creating customer value for cruise line companies will increase brand loyalty, market share, price, and ultimately lead to higher profits. For cruise lines, more passengers equal more revenue. According to CLIA’s *2018 U.S. Economic Impact Analysis*, 12.68 million passengers embarked from U.S. ports in 2018, an 8.8% increase from 2016.<sup>85</sup> Modern-day cruise ships are the largest in the industry’s entire history. The largest cruise ship as of 2020, Royal Caribbean’s Symphony of the Seas, can hold up to 6,680 passengers and 2,200 crew members on any given sailing.<sup>86</sup> The Symphony of the Seas expects to make an average profit of \$227 a customer per day, which means it can easily bring in a profit of

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82. ROCHDALE REPORT, *supra* note 26, ¶ 311

83. I.M. Sinan, *UNCTAD and Flags of Convenience*, 18 J. WORLD TRADE L. 95, 107 (1984).

84. *Id.*

85. CRUISE LINES INT’L ASS’N, CONTRIBUTION OF THE INTERNATIONAL CRUISE INDUSTRY TO THE U.S ECONOMY IN 2018, 2 (2019) [hereinafter CLIA].

86. Mark Matousek, *The Biggest Cruise Ship in the World Has Robot Bartenders, a Water Slide with 92-foot Drop, and a Nine-Story Zip-line – Here’s What It Looks Like*, BUS. INSIDER (Feb. 24, 2020, 8:19 AM), <https://www.businessinsider.com/royal-caribbean-debuts-worlds-largest-cruise-ship-photos-2018-4>.

\$1.36 million a week.<sup>87</sup> However, because the cruise industry is only an American industry<sup>88</sup> on its surface, the majority of cruise line companies pay a 0.8% tax on their revenue, far below the U.S. corporate tax rate of 21%.<sup>89</sup>

The first step towards implementing a uniform tax policy for cruise line revenue, that is based on patron created value, requires an understanding of how many passengers from developed states are creating customer value for cruise line companies. This value can be determined through annual reports by cruise line parent corporations, which consider the revenue generated in various parts of the world from each of their cruise lines. According to CLIA's *2018 Global Economic Impact Study*, North America accounted for half of all cruise passengers with 14.3 million passengers, Europe was next with 25% and 7.2 million passengers, and the rest of the world accounted for the remaining 25% with 7.0 million passengers.<sup>90</sup> The United States alone accounted for 45.9% of cruise passengers in the world, followed by China, Germany, United Kingdom, Australia, Canada, Italy, Spain, France, and Brazil,<sup>91</sup> most of whom are developed countries. Finally, it is important to note that 89% of North American passengers sailed to the Caribbean in 2018. According to the United Nations' *World Economic Situation and Prospects 2020*, the Caribbean falls in a geographical region of developing economies.<sup>92</sup>

If passengers create value, it means that profits are being made simply from developed countries where most passengers sail from. Thus, cruise line companies should be taxed because they take in money from a developed country while paying virtually no corporate taxes in developing countries. The money collected from developed countries by taxing cruise line companies can be used to fund the resources needed to inspect cruise ships

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87. Tanner Callais, *How Much the Biggest Cruise Ships (and Cruise Lines) Make Each Day*, CRUZELY (Mar. 23, 2019), <https://www.cruzely.com/how-much-the-biggest-cruise-ships-and-cruise-lines-make-each-day/>.

88. The cruise industry is an "American industry" on its surface because, although the three largest cruise companies are headquartered in Miami, Florida, all but one major cruise ship are registered outside the United States. Norwegian Cruise Line's *Pride of America* is the only major cruise ship flagged under the U.S. flag. The reason is because the *Pride of America* remains in the Hawaiian Islands year-round. The Jones Act prohibits foreign built and owned ships from transporting goods domestically in the United States. See Jana Kasperkevic, *Why There Is Only One Cruise Ship in the World with an All-American Crew*, MARKETPLACE (Sept. 29, 2017), <https://www.marketplace.org/2017/09/29/working-cruise-ship-america-jobs-hiring/>.

89. Zachary Crockett, *The Economics of Cruise Ships*, THE HUSTLE (Mar. 15, 2020), <https://thehustle.co/the-economics-of-cruise-ships/>.

90. CLIA, *supra* note 85.

91. *Id.* at 12.

92. See U.N. DEP'T OF ECON. & SOC. AFFAIRS ET AL., *WORLD ECONOMIC SITUATIONS AND PROSPECTS 2020*, at 4, U.N. Sales No. E.20.II.C.1 (2020).

and enforce existing international maritime regulations. In return, cruise lines will be able to operate profitably and in the public interest.

*C. Total Uniformity in Setting Cruise Industry Standards*

Implementing major changes in the cruise industry's operations and regulations is a long-term goal that will face powerful opposition from cruise line lobbyists. However, change is not impossible. New cruise ship regulations aiming to address safety issues are precedent in showing that adopting new regulations in the cruise industry is attainable. For example, CLIA demonstrated its ability to work effectively with IMO to adopt new industry-wide safety regulations following the Costa Concordia disaster.

The best regulation model for the cruise industry would be complete international uniformity in setting standards. Achieving that goal would render the flag registry issue moot. The IMO and its member states should seek to achieve reasonable international standards that better protect the safety of passengers and crew, the environment, and achieve equitable taxation. In adopting these standards, it is critical that the industry not be precluded from operating at scale. Raising taxes on cruise lines may raise cruise prices since when the costs go up, the cruise lines will inevitably raise their charges. However, cruise lines may tolerate higher costs more readily if costs are imposed across the board. This change requires international efforts to remedy the issue of flags of convenience because equal treatment will be critical to prevent some cruise lines from facing a competitive disadvantage in the industry.

Preventing cruise line companies from registering their vessels in countries with open registries and putting an end to the century-old maritime business practice of flying flags of convenience is not the right move. The economic dependency of developing states upon developed countries is a negative result of flags of convenience. Many of the problems associated with flags of convenience could be greatly reduced through a uniform tax policy and new industry standards. Creating a uniform tax policy for the cruise industry on an international basis will be done through the IMO. The IMO is the only international body that has the resources and mechanisms for ensuring some degree of uniformity in compliance with international regulations.<sup>93</sup> Currently, the IMO has 174 Member States, which includes 173 of the United Nations Members States plus the Cook Islands.<sup>94</sup>

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93. Anderson, *supra* note 21, at 169.

94. *Member States, IGOs and NGOs*, INT'L MAR. ORG., <https://www.imo.org/en/About/Membership> (last visited Apr. 11, 2022).

## V. CONCLUSION

Addressing the need to develop further research in a uniform tax policy for the cruise industry is a preliminary step in combatting the issues that come from flags of convenience and open registries. By acknowledging that passengers from developed states create value, a uniform tax policy will capture profits earned by cruise line companies. This uniform tax policy deserves further research. This solution considers developing states' need to build their economies and become less dependent upon developed countries where cruise companies are headquartered. A uniform tax on the cruise industry might serve as a testing ground and open room for ideas to eventually find a way to stop entrepreneurs from developed countries from exploiting developing states for corporate profit.

Lawmakers in the United States and critics of open registries around the world must understand that flags of convenience are vital for the cruise industry and critical for the economies of many developing states. Cruise line companies have made it clear that they have no problem with corporate tax loopholes in the current taxation system, and abolishing flags of convenience will not end the search for lower-cost options for these firms. International organizations have also made it clear that cruise lines choose to constantly violate international maritime laws regarding pollution and passenger and crew safety. Thus, a more realistic reform should address more equitable treatment in taxation and regulation, because a justly taxed cruise industry will not come about unless beneficiary companies allow cruise line companies to operate profitably and in the public interest.