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The Influence of Islamic Social Reporting and Financial Distress on Tax Avoidance with Profitability as a Mediating Variable: Study on Islamic Commercial Banks

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Abstrak

This study analyzes the influence of Islamic Social Reporting (ISR) and Financial Distress on Tax Avoidance, with Profitability as a mediating variable, focusing on Islamic Commercial Banks in Indonesia. This quantitative research utilizes secondary data from annual financial reports of banks registered with the Financial Services Authority (OJK) from 2021 to 2023. The sample was selected using purposive sampling, yielding 33 observational data points from 11 Islamic Commercial Banks that met the criteria. Data analysis was performed using descriptive statistics, multiple linear regression, classical assumption tests, hypothesis testing, and the Sobel test with SPSS version 25. The results indicate that ISR has a positive and significant effect on Tax Avoidance, and Financial Distress also positively and significantly impacts Tax Avoidance. ISR is found to have a strong positive effect on Profitability, while Financial Distress negatively affects Profitability. Profitability itself demonstrates a positive effect on Tax Avoidance. Furthermore, Profitability mediates the relationship between ISR and Tax Avoidance, and also significantly mediates the relationship between Financial Distress and Tax Avoidance. These findings suggest that both transparency in socio-religious reporting and the financial condition of companies influence tax avoidance strategies, with profitability playing a crucial role in explaining this behavior.

Kata Kunci: *Islamic Social Reporting; Financial Distress; Tax Avoidance; Profitability; Islamic Commercial Banks*

Introduction

Indonesia's State Budget (APBN) serves as a cornerstone for national development, with taxation representing the primary revenue source as mandated by Law No. 17 of 2003 on State Finance and Article 23A of the 1945 Constitution. The government continuously strives to enhance tax revenues to achieve fiscal independence and fund development programs that improve citizen welfare and quality of life.

Tax collection performance during 2019-2023 demonstrated a positive trajectory despite initial challenges. In 2019, actual receipts reached 83.87% of targets, indicating structural constraints in tax management. The COVID-19 pandemic in 2020 reduced realization to 89.31% of targets, reflecting significant economic impact. However, from 2021 onwards, tax receipts began exceeding targets at 100.23%, marking economic recovery and successful tax policy implementation. In 2022 and 2023, realizations reached 115.63% and 106.00% respectively, supported by tax reforms, service digitalization, and intensive oversight (Komwasjak.kemenkeu.go.id).

Taxation, as regulated by Law No. 6 of 1983 on General Provisions and Tax Procedures (last amended by Law No. 28 of 2007), is defined as mandatory contributions imposed on individuals or business entities. Tax serves as a primary state revenue source, with receipts reaching 108.8% of targets by December 2023 (www.kemenkeu.go.id). Tax benefits are evident in various life aspects including healthcare facilities, transportation, education, and public infrastructure, while also servicing foreign debt obligations. The conflict of interest between taxpayers and government often triggers tax resistance. According to Hermawan (2015), tax resistance can be classified into passive resistance (indirect obstacles related to economic structure) and active resistance (direct actions aimed at avoiding tax obligations). Legal tax reduction efforts are known as tax avoidance, while illegal tax reduction constitutes tax evasion. Although tax avoidance remains within legal boundaries, governments typically discourage such practices as they potentially reduce tax revenues (Riantami and Triyanto, 2018).

Notable tax avoidance cases in Indonesia include PT Bank Panin Indonesia in 2021, involving alleged bribery related to tax obligation manipulation. The case revealed tax underpayment of Rp 926 billion based on General Ledger audits and tax risk analysis showing Rp 81 billion in tax effects. Additionally, a former tax division head at Bank Aceh embezzled Rp 2.3 billion in employee taxes in 2021, resulting in a 4-year prison sentence (Kompas, 2022). From an Islamic perspective, tax avoidance lacks justification. In Islam, beyond fiqh (law), there exists akhlak (morality) which holds higher standing than fiqh. From a moral standpoint, assisting others becomes obligatory, and neglecting such responsibility is considered immoral (Nadjib, 2017). This principle is particularly relevant for Islamic banking institutions that should exemplify transparency and integrity.

Corporate Social Responsibility (CSR) in Islamic banking currently refers to the Global Reporting Initiative (GRI) Index. However, conventional GRI guidelines are considered inadequate for Islamic banking CSR disclosure (Istiani, 2015). Therefore, Islamic Social Reporting (ISR) measurement, designed according to Islamic perspectives and incorporating standards set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), is deemed more appropriate (Khoirudin, 2013). According to Waluyo (2017), financial distress represents a key factor driving companies toward tax avoidance behavior. Financial difficulties typically arise from declining economic activities. Financial analysis becomes crucial for predicting company survival, helping management and owners anticipate potential bankruptcy while evaluating short-term obligation capacity, capital structure, and future bankruptcy risks (Haryetti, 2010). Indonesia's banking sector controls approximately 93% of total financial assets (Yunus, 2003). Unhealthy banking systems that cannot function optimally impact economic activities by weakening banks' intermediation functions. Financial distress refers to conditions where financial institutions struggle to meet financial obligations, characterized by inability to pay debts, declining profitability, liquidity problems, and reduced market confidence (Jelena and Chandra, 2022).

This study aims to analyze tax avoidance practices in Islamic Commercial Banks, chosen based on Financial Services Authority (OJK) data showing fewer Islamic Commercial Banks compared to Islamic Business Units and Islamic Rural Banks. Islamic Commercial Banks operate independently without conventional bank coordination, making them more representative of Islamic principles. The research examines whether Islamic Social Reporting influences tax avoidance, how financial distress affects tax avoidance, the role of profitability as a mediating variable, and the relationships between these variables. Previous studies by Ibrahim and Muthohar (2019) and Santika (2019) show positive significant effects of Islamic Social Reporting on profitability, while Wilujeng and Yulianto (2020) demonstrate negative significant effects of financial distress on profitability. The study's theoretical contributions include advancing knowledge about ISR, financial distress, and profitability effects on tax avoidance with profitability as a mediating variable, while practical benefits extend to management, regulators, and investors in developing more responsible and sustainable business practices.

Methodology

Types and Sources of Data

This quantitative study analyzes numerical data to get insights (Sujarweni, 2015). Quantitative methods use variable indicators with corresponding numerical values based on relevant categories to objectively examine social phenomena (Sumanto, 2014). This study uses secondary data from pre-existing records (Kothari, 2004). Financial statements of Indonesian Financial Services Authority-registered Islamic commercial banks are used for secondary data.

Population and Sample

This study includes all Islamic commercial banks (Bank Umum Syariah or BUS) registered with the Financial Services Authority (OJK) from 2021 to 2023 that match the researcher's analytical characteristics (Kothari, 2004). A sample is a subset of this population that reflects its key qualities (Kothari, 2004). Purposive sampling was used to choose people depending on research goals. (1) Nationally operating Islamic commercial banks that are officially registered with the OJK; (2) banks that consistently publish complete annual financial reports for 2021 to 2023; and (3) banks that disclose sustainability reports to support Islamic Social Reporting indicator measurement. Out of 12 listed BUS institutions, 11 banks met these requirements, with one eliminated owing to a lack of sustainability reporting. Multiplying the 11 chosen banks by the three-year research period yields 33 observational data points (Otoritas Jasa Keuangan, 2024).

Operational Definition of Variables

In this quantitative study, variables are quantifiable constructs chosen by the researcher to examine the interactions between independent, dependent, and mediating factors (Kothari, 2004). Tax avoidance, the legal use of tax loopholes to reduce taxes, is the dependent variable in this study. Though not illegal, this method violates the spirit of tax legislation. The Cash Effective Tax Rate (CETR) measures tax avoidance by dividing cash taxes paid by pre-tax income (Dyreng et al., 2008). This statistic is crucial for stakeholders and investors to evaluate a firm's tax management since it affects corporate cash flow.

This research uses Islamic Social Reporting (ISR) and financial hardship as independent factors. ISR measures how much Islamic institutions reveal social responsibility. ISR includes financial and investment transparency, product responsibility, employee participation, community involvement, and environmental stewardship. It was derived from AAOIFI requirements and amended by Haniffa (2002). Content analysis of annual and sustainability reports determines ISR disclosure scores as a proportion of disclosed items out of a maximum anticipated number (Haniffa, 2002; Budi, 2021). Financial strain is measured using the Altman Z-Score model, a popular corporate bankruptcy predictor. The approach predicts financial instability using five financial measures (Altman & Hotchkiss, 2006; Edi & Tania, 2018). Z-scores below 1.81 indicate a significant danger of bankruptcy (distress zone), between 1.81 and 2.99 suggest a gray zone needing care, and above 2.99 show financial soundness.

The mediating variable in this study is profitability, or ROA. It measures a firm's asset use efficiency to create net income (Gitman & Zutter, 2019). Divide net income by total assets to determine ROA. Profitability mediates ISR and financial distress's indirect effects on tax evasion. Ibrahim and Muthohar (2019) and Santika (2019) found that ISR increases profitability, which influences a firm's tax avoidance. This shows that organizations with strong ISR processes gain stakeholder confidence and improve financial success. Profitability increases tax approach flexibility. Thus, ROA strategically links social transparency practices and financial stability to tax management choices, stressing the importance of profitability in explaining indirect tax evasion behavior.

Data Analysis Techniques

This research uses SPSS version 25 to analyze data using descriptive statistics, multiple linear regression analysis, classical assumption testing, hypothesis testing, and the Sobel test. The dataset is summarized using descriptive statistics like mean, standard deviation, variance, minimum and maximum values, range, total sum, kurtosis, and skewness (Kothari, 2004). To assess the impact of Islamic Social Reporting (ISR), financial distress (FD), and profitability (ROA) on tax avoidance (TA), a multiple linear regression model is used (Y = α + β1ISR + β2FD + β3ROA). Additionally, a regression model is created to evaluate the impact of ISR and FD on ROA: Z = α + β1ISR + β2FD. This method allows the research to analyze the factors' direct and intermediary impacts on tax evasion.

Classical assumption tests verify regression models' validity and dependability. Normality, multicollinearity, autocorrelation, and heteroscedasticity tests. After mode cutting outliers, the Kolmogorov-Smirnov technique is used to test for normalcy (Kho, 2016). Santoso (2001) also uses the P-P plot to visually analyze properly distributed residuals along the diagonal line. The multicollinearity test uses tolerance and VIF to examine independent variable correlation. If the tolerance exceeds 0.10 and the VIF is below 10, multicollinearity is absent (Kothari, 2004). These checks are necessary for accurate and bias-free regression coefficient estimation.

Durbin-Watson statistic is used to measure residual correlation across time in the autocorrelation test. A decent regression model should not include autocorrelation, with two hypotheses tested: H0 ($r = 0$) and Ha ($r \neq 0$). (Kothari 2004). The heteroscedasticity test checks whether error term variance is constant across data. Homoscedasticity is shown by a scatterplot of residuals with no systematic structure and random dispersion around the zero line (Priyatno, 2010). These diagnostic tests verify that the regression findings match Best Linear Unbiased Estimator (BLUE) requirements and that this research's model is statistically robust.

Hypothesis Testing

Hypothesis testing in this study aims to determine the influence of independent variables—such as investment decisions and dividend policy—on firm value, using a 5% significance level ($\alpha = 0.05$). To evaluate the explanatory power of the independent variables, the coefficient of determination (R^2) is employed, indicating the proportion of variance in the dependent variable that can be explained by the model. An R^2 value closer to one suggests a stronger explanatory capability, whereas a lower value indicates limited influence (Kothari, 2004). If the regression model includes only one independent variable, R^2 is applied directly to assess the strength of the relationship. Furthermore, the F-test evaluates whether all independent variables jointly have a significant effect on the dependent variable. A regression model is considered statistically significant if the p-value of the F-test is below 0.05; otherwise, the model is deemed unfit for hypothesis testing (Kothari, 2004).

In addition, the t-test is used to assess the individual impact of each independent variable on the dependent variable. The null hypothesis (Ho) posits that the coefficient of the independent variable is equal to zero, implying no significant effect, while the alternative hypothesis (Ha) asserts the opposite (Kothari, 2004). The decision criteria are based on comparing the p-value to the α level of 0.05 or analyzing the t-statistic in relation to the critical t-table value. If the p-value is less than 0.05 or the t-statistic exceeds the t-table value, the null hypothesis is rejected, indicating that the variable has a significant effect. Moreover, the Sobel test is conducted to assess the significance of mediating effects within the model. As proposed by Sobel (1982), the test determines whether the indirect effect of an independent variable on a dependent variable through a mediator is statistically significant. A Z-score exceeding ±1.96 indicates a significant mediation effect. This approach is particularly useful in identifying indirect relationships in social science and business research.

Result and Discussion

Descriptive Statistical Analysis

Before hypothesis testing, descriptive statistical analysis was performed to summarize each study variable's data. The study's four variables—Islamic Social Reporting (ISR), Financial Distress, Tax Avoidance, and Profitability—have lowest, maximum, mean, and standard deviation values. Table 4.1 shows 33 firms in the sample. ISR values vary from 0.37 to 0.74, with a mean of 0.5941 and a standard deviation of 0.08224. Companies reveal 59.41% of ISR indicators on average. Assuming 44 ISR items, the mean suggests that each firm discloses 26 items, indicating strong compliance with Islamic social disclosure rules and low standard deviation.

Table 1. Descriptive Statistic

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Tax Avoidance	33	0,02	0,31	0,2233	0,07056
Islamic Social Reporting	33	0,37	0,74	0,5941	0,08224
Financial Distress	33	0,43	7,71	2,0902	1,92248
Profitability	33	0,00	1,13	0,4274	0,29257

Financial Distress, possibly evaluated by the Altman Z-Score or a comparable metric, ranges from 0.43 to 7.71 with a mean of 2.0902 and a standard deviation of 1.92248. The average score shows that enterprises are financially stable, but the high maximum value and huge standard deviation show severe financial instability throughout the sample. Some companies are financially stable, while others may be at danger. Tax avoidance ratings range from 0.02 to 0.31, with a mean of 0.2233 and a standard deviation of 0.07056, indicating modest and consistent corporate behavior. Profitability averages 0.4274 and has a standard deviation of 0.29257, ranging from 0.00 to 1.13. This shows that firms average 42.74% on assets or equity, but the significant variability suggests unequal financial performance (SPSS 25, 2024).

Classical Assumption Test

Classical assumption tests for normality, multicollinearity, heteroscedasticity, and autocorrelation were performed to verify the regression model. A P-Plot and K-S test showed that the residuals are normally distributed. The P-Plot data points match the diagonal line, and the K-S test yielded a 0.109 test statistic with an Asymp. Sig (2-tailed) of 0.200. This significance level surpasses 0.05, confirming that the residuals are normal (SPSS 25, 2024). Thus, the regression model meets the normality condition and is suitable for analysis.

Tolerance and VIF were used to assess multicollinearity. Table 4.3 shows that all independent variables have VIF values below 10 and tolerance values over 0.1, suggesting no significant predictor associations. Each independent variable adds unique information to the model without duplication (SPSS 25, 2024). Autocorrelation was examined using the Durbin-Watson test, which yielded 1.913, within the allowed 1.5 to 2.5 range. The model's independence assumption is supported by the residuals' lack of serial correlation (SPSS 25, 2024). Finally, a scatterplot of standardized residuals vs anticipated values examined heteroscedasticity. The graphic depicts random dots without funnel forms, showing that residual variance is uniform across all independent variable levels. We meet the homoscedasticity assumption. These assumptions guarantee the regression model is statistically sound and offers a solid foundation for interpretation and inference in this investigation.

Coefficient of Determination Test

The coefficient of determination (R Square) shows a value of 0.477, indicating that approximately 47.7% of the variation in tax avoidance behavior can be accounted for by the independent variables: Islamic Social Reporting (ISR), financial distress (FD), and profitability (PROFIT). Meanwhile, the remaining 52.3% of the variance is likely influenced by other factors not included in the model. This level of explanatory power suggests a moderate relationship between the predictors and the dependent variable, affirming that while the model is informative, it does not capture all determinants of tax avoidance (SPSS 25, 2024).

F Test

The simultaneous significance test gives the regression model an F-value of 12.078 with a 0.001 significance threshold. The significance value is below 0.05, indicating that profitability, Islamic Social Reporting (ISR), and financial difficulty together impact tax evasion. This shows that the regression model can explain how these factors affect the dependent variable. The low p-value strongly rejects the null hypothesis, indicating that at least one independent variable substantially affects tax evasion. Thus, this model may be used to evaluate and analyze how ISR, financial health, and profit performance affect company tax behavior (SPSS 25, 2024).

t Test

The t-test outcomes shown in Table 2 reveal that Islamic Social Reporting (ISR) positively influences Tax Avoidance, as evidenced by a coefficient of 0.078 and a significance level of 0.006. This indicates that an increase in ISR corresponds with an increase in Tax Avoidance, thus supporting hypothesis H1. Similarly, Financial Distress also exerts a positive and significant impact on Tax Avoidance, with a coefficient of 0.018 and a significance of 0.025, confirming hypothesis H2. Additionally, ISR demonstrates a strong positive effect on Profitability, reflected by a coefficient of 0.496 and a significance of 0.004, which supports H3.

Table 2. t-test

Hypothesis	Effect Direction	B	Sig.	Conclusion
H1	+	0.078	0.006	Supported
H2	+	0.018	0.025	Supported
H3	+	0.496	0.004	Supported
H4	-	-0.084	0.001	Supported
H5	+	0.031	0.002	Supported

Source: Processed data using SPSS 25 (2024)

The t-test outcomes shown in Table 4.7 reveal that Islamic Social Reporting (ISR) positively influences Tax Avoidance, as evidenced by a coefficient of 0.078 and a significance level of 0.006. This indicates that an increase in ISR corresponds with an increase in Tax Avoidance, thus supporting hypothesis H1. Similarly, Financial Distress also exerts a positive and significant impact on Tax Avoidance, with a coefficient of 0.018 and a significance of 0.025, confirming hypothesis H2. Additionally, ISR demonstrates a strong positive effect on Profitability, reflected by a coefficient of 0.496 and a significance of 0.004, which supports H3.

Mediation Test

The mediation test examined whether the mediating variable mediates the independent-dependent connection. Path analysis was performed to examine direct and indirect effects among variables, and the Sobel test was utilized to evaluate mediation effects' statistical significance. The path analysis showed that Islamic Social Reporting (ISR) and Financial Distress directly and indirectly affect Tax Avoidance via Profitability. Higher ISR disclosures promote Tax Avoidance, however the effect magnitude is minimal (coefficient = 0.006). This may indicate symbolic practices where firms report social activities to excuse tax evasion. ISR indirectly boosts Profitability (0.004), which boosts Tax Avoidance (0.031). The indirect impact of ISR on Tax Avoidance is 0.000124, which is favorable but small. Companies with superior ISR are more lucrative, which supports tax optimization. ISR has a little indirect influence on Tax Avoidance, but the direct effect is 0.006 and dominates. Financial distress directly and positively influences tax avoidance by 0.015, indicating enterprises under financial strain avoid taxes to retain liquidity and decrease commitments.

Table 3. The mediation test

Hypothesis	Direction	Sig.	Conclusion
H6	+	0.006	Supported
H7	+	0.005	Supported

Source: Processed data using SPSS 25 (2024)

Financial Distress positively impacts Profitability by 0.001, and Profitability positively affects Tax Avoidance by 0.031, providing an indirect effect of roughly 0.000031. Profitability mediates somewhat and weakly since this indirect impact is much lower than the direct effect. Sobel test findings for Profitability's mediation impact in the ISR-Tax Avoidance association showed a Z-value of 0.5233 and a p-value of 0.006, indicating 5% mediation. The tiny coefficient and substantial standard error weaken the mediation effect. Financial Distress's Sobel test showed substantial mediation with a Z-value of 0.6317 and a p-value of 0.005. The reduced standard error in this route reflects a more persistent mediation effect than ISR. Profitability considerably mediates the effects of ISR and Financial Distress on Tax Avoidance, however the severity varies.

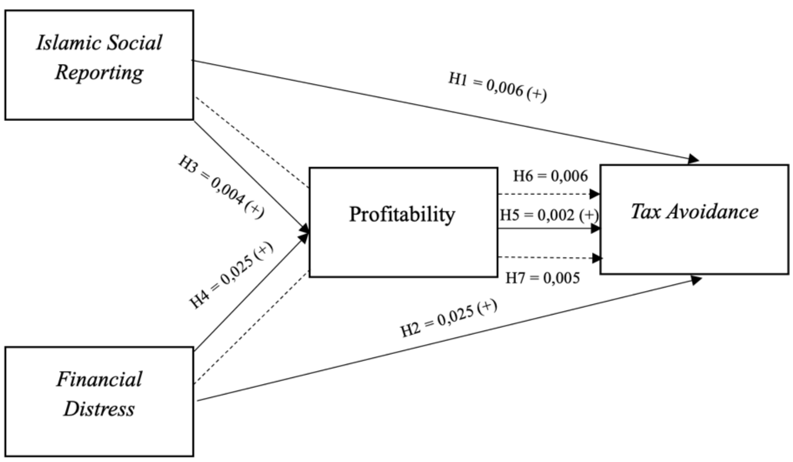

Figure 1. Path Analysis

Multiple Linear Regression Analysis

Multiple linear regression shows that Islamic Social Reporting (ISR), Financial Distress (FD), and Return on Assets (ROA) all positively affect Tax Avoidance. Tax Avoidance is anticipated to be at 0.227 even when other independent variables are zero, demonstrating that external influences may impact tax avoidance. ISR has the biggest coefficient of 0.078, indicating that enterprises with more social reporting activities participate in more tax planning. Financial distress, with a coefficient of 0.018, also has a positive but moderate impact, suggesting that financially stressed enterprises may dodge taxes to save expenses. To optimize tax obligations, profitable enterprises enhance tax evasion (ROA = 0.031).

ISR positively influences Profitability with a coefficient of 0.496 and a significance level of 0.004, indicating each unit increase in ISR enhances Profitability by 0.496 units, assuming other variables remain constant. Financial distress decreases profitability with a coefficient of -0.084 and a significance of 0.001. The t-values for ISR (0.903) and FD (-3.579) indicate that Financial Distress negatively affects Profitability more than ISR positively.

The Effect of Islamic Social Reporting on Tax Avoidance

The regression study shows that Islamic Social Reporting (ISR) positively and statistically significantly affects Tax Avoidance (coefficient = 0.078, p-value = 0.006). The increased ISR disclosure in financial statements shows that corporations are more likely to dodge taxes. ISR increases a company's social reporting transparency and allows it to design tax strategies to lawfully reduce its tax burden. According to stakeholder theory (Freeman, 1984), firms owe numerous stakeholders, including the government as tax collector. However, firms generally prioritize shareholder interests by avoiding taxes to maximize profits. Large ISR disclosure firms may deliberately optimize their tax arrangements to retain industry competitiveness.

Ibrahim and Muthohar (2019) discovered that enterprises with broad ISR disclosures pursue more strategic financial policies, particularly tax-related ones. Santika (2019) found that ISR may improve firm reputation, making tax planning easier without tax authority scrutiny. ISR increases openness and gives corporations more flexibility to manage their tax strategies. According to agency theory (Jensen & Meckling, 1976), managers behave as agents to maintain the firm's image before investors and maximize profitability. High ISR enterprises may display social engagement while executing tax avoidance methods within legal limitations, demonstrating a dual tax management strategy. This research shows that ISR improves transparency and ethical tax evasion.

The Effect of Financial Distress on Tax Avoidance

The regression findings show that Financial Distress positively affects Tax Avoidance with a coefficient of 0.018 and a significance level of 0.025. This suggests that financially struggling firms are more likely to dodge taxes. Firms in financial distress generally experience significant liquidity difficulties, forcing attempts to cut expenditures, including taxes. Agency theory states that managers are incentivized to protect the company's financial stability, even if it means reducing tax collections. This conduct shows how the company's existence and economic obligations conflict.

These results confirm Taufik and Muliana (2021), who demonstrated that financially troubled enterprises use aggressive tax evasion methods to survive. Swandewi and Noviari (2020) found that financially stressed enterprises are more likely to use tax loopholes to reduce their tax bills. In financial crises, stakeholder theory says corporations and the government have a more complex relationship. While tax revenues are crucial to the government, troubled enterprises have trouble paying their taxes. These companies explore methods to reduce taxes to stay in business. The findings show that financial difficulty strongly impacts enterprises' tax evasion strategies to maintain financial stability.

The Effect of Islamic Social Responsibility on Profitability

Islamic Social Responsibility (ISR) positively affects Profitability with a regression coefficient of 0.496 and a significance level of 0.004 (less than 0.05). increased ISR disclosure in financial reports may lead to increased profits. Good ISR disclosure increases the company's public image and stakeholder confidence, which boosts financial performance. Companies build goodwill and economic rewards by being socially responsible.

Stakeholder theory (Freeman, 1984) states that corporations that actively serve communities, workers, and government bodies achieve social legitimacy. Legitimacy boosts client loyalty, company reputation, and profitability. Ibrahim and Muthohar (2019) discovered a favorable association between ISR disclosure and financial success, indicating that socially responsible enterprises gain more market support. Santika (2019) said that ISR boosts a company's competitiveness and earnings. Agency theory (Jensen & Meckling, 1976) further states that transparent ISR policies alleviate manager-owner disputes by demonstrating management commitment to long-term organizational objectives. This research shows that ISR satisfies social and ethical obligations and boosts corporate profitability.

The Effect of Financial Distress on Profitability

The regression analysis shows that Financial Distress negatively impacts Profitability with a coefficient of -0.084 and a significance level of 0.001 (less than 0.05). As a company's finances worsen, its profit potential drops. Financial problems slow operations, diminish efficiency, and restrict revenue. Due to cash difficulties, Financial Distressed companies typically allocate resources inefficiently and make poor decisions. Agency theory states that managers under financial pressure may choose defensive or short-term methods that hurt the firm's finances.

These results match earlier studies. Financially distressed enterprises have lower profitability, according to Taufik and Muliana (2021). Swandewi and Noviari (2020) found that operational inefficiencies hurt distressed enterprises' profitability. Investors, creditors, and consumers may lose faith in financially distressed organizations, according to stakeholder theory. This lack of trust may worsen the firm's finances, raising risks and lowering profitability potential. This research shows that a company's financial well-being is vital to its profitability, with more financial hardship resulting in lower profits.

The Effect of Profitability on Tax Avoidance

The model shows that Profitability positively affects Tax Avoidance with a coefficient of 0.031 and a significance value of 0.002 (less than 0.05). This shows that profitable corporations avoid taxes more often. According to agency theory, profitable corporations are more likely to reduce their tax burden to maximize shareholder returns. Managers may believe tax avoidance methods boost financial efficiency and protect investors.

This supports Putri and Putra (2017), who showed that highly successful corporations are more aggressive in tax evasion. Chen et al. (2010) noted that successful enterprises have greater resources to develop sophisticated tax planning strategies that legitimately lower tax bills. Profitable corporations have more obligations to shareholders, investors, and governments, according to stakeholder theory. However, to maintain profit levels, these corporations tend to use tax management methods that reduce tax costs without violating laws. The research found that increasing profitability increases tax evasion, showing that profit performance affects a company's tax strategy and financial success.

Profitability Mediates Islamic Social Reporting and Tax Avoidance

Profitability is a key mediator between Islamic Social Reporting (ISR) and Tax Avoidance. Sobel test findings show a significance value of 0.006, indicating that corporate profitability indirectly affects ISR and Tax Avoidance. Companies that reveal greater ISR levels are more profitable, which influences their tax evasion actions. ISR may reduce tax evasion by improving financial performance.

Islamic Social Reporting shows a company's transparency in social and environmental issues based on Islamic standards. Large ISR disclosures usually increase investor, consumer, and regulatory confidence. Trust improves client loyalty and makes external finance easier, increasing profitability. Greater earnings flexibility allows corporations to better manage their tax strategy. Profitable firms have greater resources to employ intricate and legal tax planning procedures that lower tax bills. By increasing profitability, ISR indirectly helps avoid taxes by allowing more strategic and planned tax management.

When a corporation has high ISR and good profitability, agency theory suggests managers would aggressively pursue tax reduction possibilities to maximize shareholder value. According to stakeholder theory, corporations have obligations to varied stakeholders including tax authorities and investors anticipating high returns. ISR maintains the company's brand and social responsibility while optimizing tax planning for shareholder benefit. Ibrahim and Muthohar (2019) and Santika (2019) discovered that enterprises with higher ISR are more profitable, allowing for more flexible tax tactics. The results show that ISR indirectly affects Tax Avoidance via profitability, underscoring profitability's crucial role in this connection.

Profitability Mediates Financial Distress and Tax Avoidance

The Sobel test shows that profitability mediates the association between financial difficulty and tax evasion ($p = 0.005$). This suggests that financially distressed enterprises may still dodge taxes if they are profitable. Profitability amplifies the impact of financial difficulty on tax evasion. This implies that a company's capacity to create profit shapes its tax planning techniques even in financial trouble. Financial hardship occurs when a corporation has substantial financial issues that jeopardize operations. To sustain cash flow and liquidity, corporations cut non-essential costs, including taxes. Companies in financial distress are more likely to use strategic tax management. If these enterprises remain profitable, they may use more aggressive tax dodging techniques. This flexibility lets financially challenged but successful enterprises optimize tax costs while maintaining operations.

Agency theory states that managers in financially challenged organizations decrease tax bills to stabilize the company. Firms in financial trouble but nonetheless making good profits have more motivation to evade taxes since it helps maintain profitability. Profitability mediates the financial distress-tax evasion relationship. Profitability mediates both Islamic Social Reporting and tax avoidance, as well as financial difficulty and tax avoidance. Companies with high ISR are more profitable and have more tax strategy flexibility, whereas financially distressed enterprises with adequate profitability employ tax evasion to stay afloat. Profitability is a crucial component in how corporations construct tax solutions under different financial conditions.

Conclusion and Recommendation

With profitability as a mediating variable, Islamic Social Reporting (ISR) and Financial Distress affect Tax Avoidance in this research. First, ISR positively and substantially influences Tax Avoidance, demonstrating that corporations with more ISR disclosure engage in more tax avoidance. This shows that accurate reporting of social and environmental duties improves corporate transparency and helps corporations manage their tax liabilities strategically. Second, Financial Distress encourages Tax Avoidance since enterprises in financial distress seek legal ways to lower taxes to retain liquidity and operational continuity. ISR boosts profitability, thus organizations that prioritize social reporting prosper. However, Financial Distress lowers Profitability, indicating that financial problems lower profits. Profitability increases Tax Avoidance because more prosperous organizations have more resources and freedom to design intricate tax methods. Profitability mediates the link between ISR and Tax Avoidance and Financial hardship and Tax Avoidance, demonstrating its importance in understanding how corporations adapt their tax methods depending on financial transparency and hardship.

Although insightful, this study has significant drawbacks. The research is limited to Indonesia's Islamic banking industry, which may limit its applicability to other businesses with distinct tax evasion behaviours, such as manufacturing or technology. The data also covers a short time period, which may have been impacted by economic circumstances and tax legislation. Tax evasion tendencies may be better understood with a longer time horizon. The study solely considers ISR, Financial Distress, and Profitability as tax avoidance factors, ignoring company governance, leverage, and tax policy changes. Secondary data from financial reports limits comprehension of organizations' tax strategy; primary data from finance management interviews might provide more information.

Based on results and constraints, various suggestions are made. To capture wider tax evasion implications, future study should incorporate strong business governance, Islamic performance indicators, and market responses. Extending the study to other businesses than Islamic banking and extending the research time will strengthen and apply the findings. Qualitative methodologies like manager interviews may illuminate tax evasion decision-making. Companies should balance tax evasion with regulatory compliance to minimize legal risks and create stakeholder confidence via ISR. Financially distressed firms should explore tax alternatives that protect their sustainability without violating laws. Meanwhile, policymakers should improve Islamic banking tax evasion supervision and ISR rules to integrate social responsibility reporting with tax compliance. Tax incentives for high ISR and tax compliance might encourage responsible business.

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