Financial Determinants of Tax Avoidance: Empirical Study of Islamic Banks in Asia and COVID-19 Review

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Abstract

This study investigates the effects of profitability, firm size, leverage, and financial constraints on tax avoidance in Islamic banks across Asia. The research model was tested both before and during the COVID-19 pandemic, using data obtained from the Osiris database. The sample consisted of 22 Islamic banks in Asia that had complete data and reported profits during the observation period from 2016 to 2023. The data were analyzed using balanced panel data regression with the assistance of EViews software. Tax avoidance was measured using both the Effective Tax Rate (ETR) and Book–Tax Differences (BTD). The results indicate that profitability has a significant positive effect on tax avoidance. Firm size demonstrates a significant negative effect on tax avoidance during the COVID-19 period. Leverage consistently shows a significant negative effect on tax avoidance, both before and during the pandemic. Financial constraints exhibit a significant positive effect only during the pandemic. The study offers several implications: (1) Islamic bank management should balance capital structure to avoid overreliance on leverage; (2) highly profitable banks are encouraged to maintain their reputation and public trust by ensuring tax compliance; and (3) regulators need to strengthen oversight, particularly in unstable economic environments.

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Introduction

Tax revenue is a critical component of national sustainability, particularly in the Asian region, which is dominated by developing countries. In the context of globalization and increasing business complexity, these countries must strengthen their tax systems (Kurniati, 2024). To enhance tax revenue, various efforts have been pursued, including tax policy reform, improved supervision and law enforcement, and digitalization of tax administration (Nita & Rivani, 2025). Despite these initiatives, tax performance remains weak. In 2023, the ratio of tax revenue to GDP in the Asia-Pacific region averaged only 19.6%, far below the OECD average of 33.9% (OECD, 2023). Countries such as Bangladesh (7.3%), Sri Lanka (10%), Indonesia (12%), and Hong Kong (13.1%) recorded particularly low ratios (OECD, 2023). This shortfall is further exacerbated by corporate tax avoidance practices, which diminish potential state revenue.

Tax avoidance refers to the manipulation of "tax affairs" that remains within the legal framework of tax regulations (Suandy, 2017). While it is not illegal, it reduces tax liabilities by exploiting loopholes in

the law. This practice is particularly problematic in the banking sector, given its strategic role in mobilizing funds, channeling investments, and facilitating both domestic and international trade (Singh et al., 2022). Financial institutions generate significant taxable transactions, but banks often minimize tax obligations by inflating costs, thereby lowering reported profits and reducing taxes owed (Putri et al., 2024). Consequently, tax avoidance reduces government revenue that could otherwise be allocated to public development, potentially hindering economic growth (Abid & Dammak, 2021; Night & Bananuka, 2020).

In the context of Islamic banking, tax avoidance raises further concerns, as banks must comply not only with legal requirements but also with Islamic principles. Unlike conventional banks, Islamic banks are supervised by a Sharia Supervisory Board, which ensures compliance with Sharia principles (Ajili & Bouri, 2018; Naufal et al., 2024). While tax evasion is clearly illegal, tax avoidance is considered permissible under certain conditions (Jalili, 2011). However, from an Islamic perspective, tax avoidance may conflict with values of justice and social responsibility. Such practices undermine the mission of Islamic banks to alleviate poverty and promote fairness (Taufik, 2023). They also risk creating the perception of greed and self-interest (Putri et al., 2024). Empirical evidence further suggests that firms located in more religious environments are more likely to comply with tax obligations and less inclined to engage in tax management strategies (Boone et al., 2013). This highlights the relevance of examining tax avoidance in Islamic banks, which are expected to align their practices with religious and ethical values.

The Islamic banking industry is expanding rapidly in Asia. In the Islamic finance market, the Asia-Pacific region is the second largest in the world, accounting for 20.7% of total global assets—equivalent to USD 1.9 trillion by the end of 2022 (Madni, 2023). Abu Dhabi's largest Islamic bank has also announced plans to acquire a USD 1.1 billion minority stake in Bank Syariah Indonesia to strengthen its presence in the fast-growing Southeast Asian market (Ngui & Sulaiman, 2024). Similarly, Maybank Islamic is enhancing its digital services to expand its market reach in key Southeast Asian countries (Fintech News Malaysia, 2025). Such expansion activities contribute not only to the growth of the banking industry but also to national economies, including through significant potential increases in tax revenue.

Research on tax avoidance in the banking sector has been conducted in several countries, such as Bangladesh (Hossain et al., 2024), Indonesia and Malaysia (Taufik, 2023), China (Sun et al., 2023), and Ghana (Seidu et al., 2023). However, these studies are generally limited to one or two countries and have not comprehensively examined tax avoidance in a broader Asian context. This gap is critical, as many Asian banks operate across borders and are exposed to diverse tax regulations, creating opportunities for income shifting as a tax planning strategy (Demeré & Gramlich, 2019). Mechanisms such as transfer pricing, the use of intangible assets, and multinational structures are often employed to minimize tax burdens (Hidayat et al., 2024)**.** The leak of the Panama Papers further underscored Asia's central role in offshore wealth management, prompting regulators in Hong Kong and Singapore to increase oversight by requiring banks to scrutinize transactions and relationships with entities and individuals linked to offshore companies (Chatterjee et al., 2016). Such cases highlight the region's vulnerability to tax avoidance practices. This study employs data from 2016 to 2023 to assess whether tax avoidance practices among Islamic banks differed before and during the COVID-19 pandemic. Globally, the pandemic has been shown to stimulate tax avoidance activities (Zhu et al., 2023). Accordingly, this study seeks to fill the gap by analyzing tax avoidance practices in Islamic banks across Asia, thereby providing a more comprehensive understanding of the factors influencing tax avoidance in a cross-country context.

More specifically, this research examines the effects of profitability, firm size, leverage, and financial constraints on tax avoidance. These variables are commonly recognized as key indicators of corporate financial management behavior. Prior studies have identified profitability, firm size, and leverage as significant factors influencing tax avoidance (Hossain et al., 2024), while financial constraints also play a critical role in banks' decisions to engage in tax avoidance (Jin et al., 2022). By considering these four variables, this study aims to evaluate the determinants of tax avoidance in Islamic banks operating in Asia and to analyze potential differences before and during the COVID-19 pandemic. The findings are

expected to provide valuable insights for regulators and policymakers in designing effective strategies to prevent tax avoidance in Islamic banking.

Literature Review

Theoretical Framework

Prior research has frequently employed Agency Theory as a basis for examining tax avoidance practices (Galingging, 2024; Hossain et al., 2024; Sopiyana, 2022; Sumaryati & Prawitasari, 2022; Ulfa et al., 2021). According to agency theory, conflicts arise from information asymmetry, which allows managers to act opportunistically (Jensen & Meckling, 1976). These conflicts can shape a company's tendency to adopt aggressive tax strategies (Galingging, 2024). For instance, managers may seek to increase compensation by reporting higher earnings (Dianawati & Agustina, 2020), while shareholders may prefer reduced tax expenses achieved through lower profits (Galingging, 2024; Sumaryati & Prawitasari, 2022). Performance pressures, weak external oversight, and limited transparency can further encourage managers to pursue tax avoidance practices, particularly when they have financial incentives tied to equity (Wenwu et al., 2023). Within the context of financial characteristics, agency theory suggests that managerial decisions regarding profitability management, leverage, and responses to financial constraints are often influenced by such conflicts.

Profitability and Tax Avoidance

Profitability reflects a company's ability to generate earnings from its operational activities. High profitability not only indicates strong financial performance but also has direct implications for tax obligations. Previous research has shown that profitability is a key factor driving tax strategies in banks, such as those in Jordan (Shubita, 2024). Because corporate income tax is calculated on taxable profit, the higher the profit earned, the greater the tax burden. This often motivates companies to engage in tax avoidance to minimize effective tax rates (Hossain et al., 2024). Empirical studies confirm this relationship.

Several previous studies have examined the effect of profitability on tax avoidance (Darsani & Sukartha, 2021; Hendayana et al., 2024; Hossain et al., 2024; Susanto, 2022). Hossain et al. (2024), analyzing 62 Bangladeshi firms, found that profitability positively influences tax avoidance. Similar findings were reported for LQ45 companies listed on the Indonesia Stock Exchange (Hendayana et al., 2024). Other studies also reveal a strong link between bank profitability and tax avoidance (Shubita, 2024). In general, higher profitability is associated with lower effective tax rates, indicating more intensive tax avoidance practices (Darsani & Sukartha, 2021). This study proposes the first hypothesis:
H1. Profitability is a positive determinant of tax avoidance.

Company Size and Tax Avoidance

Company size is another determinant of tax avoidance (Hossain et al., 2024). Larger firms typically conduct more complex transactions and hold substantial assets, providing greater opportunities to exploit legal loopholes (Sopiyana, 2022; Ulfa et al., 2021). Furthermore, large firms often possess more skilled resources, enabling them to design and implement more sophisticated tax planning strategies (Firmansyah et al., 2021).

Empirical studies highlight this duality. While larger firms are more capable of tax planning, they are also more visible to regulators and the public, which exposes them to greater regulatory scrutiny and expectations of social responsibility (Jensen & Meckling, 1976; Watts & Zimmerman, 1986; Zimmerman, 1983). For example, Belz et al. (2019) showed a positive relationship between company size and ETR, while other studies demonstrate a positive association between size and tax avoidance, particularly among Islamic banks in Indonesia (Sayekti & Sulistyowati, 2021). Hossain et al. (2024) also report similar results across listed firms. This study proposes the second hypothesis:
H2. Company size is a positive determinant of tax avoidance.

Leverage and Tax Avoidance

Leverage refers to the extent to which a company relies on debt to finance its assets. A higher leverage ratio indicates greater dependence on external borrowing (Sopiyana, 2022). Because interest expenses on debt are tax-deductible, high leverage reduces taxable income and, consequently, corporate tax liabilities. Empirical evidence generally supports this relationship (Kurniawan, 2018; Sinaga et al., 2022). Galingging (2024), studying 64 construction firms listed on the Indonesia Stock Exchange, found that leverage positively affects tax avoidance, as debt financing enables companies to reduce tax burdens through interest deductions. Similarly, Hossain et al. (2024) reported that leverage influences tax avoidance among listed companies in Bangladesh. However, contrasting findings suggest that companies with higher debt levels may actually face lower incentives for tax avoidance, as they already benefit from more efficient tax rates (Sari & Ramli, 2023). This study proposes the third hypothesis:
H3. Leverage is a positive determinant of tax avoidance.

Financial Constraints and Tax Avoidance

Financial constraints limit firms' access to traditional funding sources such as deposits and equity, compelling them to seek alternative strategies to meet financing needs (Jin et al., 2022). In such situations, tax planning becomes an important tool for generating cash savings that reduces financial strain (Edwards et al., 2016).

Empirical evidence shows that banks under financial pressure often exploit both short-term and long-term tax planning opportunities, resulting in lower effective cash tax rates (Seidu et al., 2023). By reducing current taxable income or increasing tax credits, firms can lower their tax burdens or secure tax refunds (Jin et al., 2022). Tax savings provide firms with additional financial flexibility, enabling them to ease funding constraints and improve cash flow (Sun et al., 2023). Consequently, financial constraints are positively associated with tax avoidance. This study proposes a fourth hypothesis:
H4. Financial Constraints are a positive determinant of tax avoidance.

Research Method

This study focuses on publicly listed Islamic banks in Asia during the period 2016–2023. The financial data were obtained from the Osiris Database, developed by Bureau van Dijk, which provides financial information on public companies worldwide (Osiris, 2025). The Osiris Database is considered highly reliable as it only includes high-quality data and employs strict quality assurance procedures (Wardani & Kusuma, 2012). Numerous research articles have also used Osiris as a primary data source (Bilicka, Qi, & Xing, 2022; Wardani & Kusuma, 2012; Yohana & Pane, 2024). A balanced panel dataset of 22 Islamic banks was identified from the database. These banks consistently reported profits throughout the observation period. The sample includes banks from Jordan, Iran, Bangladesh, Kuwait, Malaysia, the Syrian Arab Republic, the United Arab Emirates, Indonesia, Palestine, and Qatar.

Tax avoidance, defined as a legal practice of reducing tax liabilities by exploiting loopholes in tax regulations without violating the law, is measured in this study using two proxies: the Effective Tax Rate (ETR) and the Book–Tax Difference (BTD). A lower ETR reflects managerial efforts to reduce tax expenses as part of earnings management (Hossain et al., 2024), while higher BTD values indicate more aggressive tax management practices (Taufik, 2023).

The independent variables are profitability, firm size, leverage, and financial constraints. Profitability, measured using Return on Assets (ROA), captures a bank's ability to generate profits from its assets (Hossain et al., 2024; Sopiyana, 2022; Ulfa et al., 2021). Higher profitability increases tax obligations (Sopiyana, 2022), thereby motivating firms to adopt tax avoidance strategies (Suhada & Ryanto, 2025). Firm size refers to the scale of a company's business, which can be determined by indicators such as total assets and sales volume (Sumaryati & Prawitasari, 2022). Firm size is measured by the natural logarithm of total assets, which reduces data dispersion without altering proportional values (Eddy et al., 2020). Leverage reflects the level of financing sourced from outside the company

(Rahmadani et al., 2020). Financial constraints are measured using the Z-Score (Jin et al., 2022). As a control variable, Fixed Asset Intensity is included, given that differences in fiscal and commercial depreciation methods may lead to adjustments that reduce pre-tax profits (Kumalawati, 2018). Table 1 presents the operational definitions and measurements of each variable.

Table 1. Measurement of Each Variable

Variable	Measurement	References
Effective tax rate (ETR)	$\frac{\text{Income Tax Expense}}{\text{Earning Before Tax}}$	(Hossain et al., 2024; Taufik, 2023)
Book Tax Difference (BTD)	$\frac{\text{Earning Before Tax + Net Income}}{\text{Total Asset}}$	(Hossain et al., 2024; Taufik, 2023)
Profitability (ROA)	$\frac{\text{Earning After Tax}}{\text{Total Asset}}$	(Hossain et al., 2024)
Firm Size (SZE)	Log Natural of Total Asset	(Hossain et al., 2024)
Leverage (LEV)	$\frac{\text{Total Debt}}{\text{Total Asset}}$	(Hossain et al., 2024)
Financial Constraint (FIC)	$\frac{\text{ROA + Equity to Asset Ratio}}{\text{Std Dev. of ROA}}$	(Jin et al., 2022)
Fix Asset Intensity (FAI)	$\frac{\text{Fix Asset}}{\text{Total Asset}}$	(Hossain et al., 2024)

The collected data were analyzed using balanced panel data regression with the assistance of EViews software. In general, this study uses balanced panel data analysis consisting of a Fixed Effect Model (FEM), a Random Effect Model (REM), and a Common Effect Model (CEM). This study uses the Chow Test, Lagrange Multiplier Test, and Hausman Test to determine the best model among FEM, REM, and CEM. The data is also examined using classical assumption tests.

Results and Discussion

Table 2 summarizes the descriptive statistics for each variable, both overall and by period (pre-COVID-19 vs. during COVID-19). Tax avoidance measured by ETR shows an average value of 0.279488, with lower ETRs during the COVID-19 period, indicating higher avoidance. Tax avoidance measured by BTD averages 0.027688, with values tending to increase during the pandemic.

Profitability (ROA) averages 0.016251, with higher values during COVID-19 compared to the pre-pandemic period. Firm size averages 0.904897, also increasing during COVID-19. Leverage has an average of 0.904897, with no notable change across periods. Financial constraint averaged 34,92671, with higher values 36,56896 during COVID-19 compared to the pre-pandemic period.

Table 2. Descriptive Statistics

All Data					
Variable	N	Mean	Std. Dev.	Min	Max
Effective tax rate (ETR)	176	0.279488	0.228193	-0.00622	1.630853
Book Tax Difference (BTD)	176	0.027688	0.023548	0.000395	0.193026
Profitability (ROA)	176	0.016251	0.011986	0.0011	0.0985
Firm Size (SZE)	176	25.5734	1.463268	22.69444	29.5051
Leverage (LEV)	176	0.904897	0.035929	0.829965	0.974767
Financial Constraint (FIC)	176	34.92671	26.11858	1.715217	155.523
Fix Asset Intensity (FAI)	176	0.014459	0.008735	0.001554	0.048853

Table 2. Descriptive Statistics (Cont.)

Before Covid-19					
Variable	N	Mean	Std. Dev.	Min	Max
Effective tax rate (ETR)	88	0.295582	0.254024	-0.00088	1.630853
Book Tax Difference (BTD)	88	0.025377	0.014005	0.000395	0.093229
Profitability (ROA)	88	0.014957	0.007027	0.0011	0.0498
Firm Size (SZE)	88	25.2798	1.394678	22.88081	28.19362
Leverage (LEV)	88	0.905151	0.033149	0.84415	0.974767
Financial Constraint (FIC)	88	36.56896	29.57837	1.715217	155.523
Fix Asset Intensity (FAI)	88	0.015258	0.009024	0.001554	0.044974
During Covid-19					
Variable	N	Mean	Std. Dev.	Min	Max
Effective tax rate (ETR)	88	0.266749	0.199092	-0.00622	0.645176
Book Tax Difference (BTD)	88	0.029821	0.030157	0.006948	0.193026
Profitability (ROA)	88	0.017481	0.015386	0.0038	0.0985
Firm Size (SZE)	88	25.85051	1.484887	22.69444	29.5051
Leverage (LEV)	88	0.905074	0.038651	0.829965	0.964159
Financial Constraint (FIC)	88	33.41428	22.38901	5.060131	94.81015
Fix Asset Intensity (FAI)	88	0.013809	0.008376	0.002241	0.048853

Source: Secondary data processed (2025)

Table 3 presents the correlation matrix. Following Hair et al. (2019), multicollinearity is indicated when correlations exceed 0.7. Since none of the variables show correlations above this threshold, multicollinearity is not a concern, and the model can be considered valid and reliable. Balanced panel regression was then conducted. Model selection used the Chow test, the Lagrange Multiplier test, and the Hausman test, leading to the Fixed Effect Model (FEM) being chosen for ETR and the Random Effect Model (REM) for BTD.

Table 3. Correlation Matrix

	ROA	SIZE	LEV	FIC	FAI
ROA	1.00000	0.03063	-0.30741	-0.19308	0.05804
SIZE	0.03063	1.00000	-0.31570	-0.02818	-0.15312
LEV	-0.30741	-0.31570	1.00000	-0.25837	0.05037
FIC	-0.19308	-0.02818	-0.25837	1.00000	-0.09768
FAI	0.05804	-0.15312	0.05037	-0.09768	1.00000

Note: ROA is profitability, SIZE is firm size, LEV is leverage, FIC is financial constraint, and FAI is fixed asset intensity

Source: Secondary data processed (2025)

Table 4 presents the regression results. The analysis shows that profitability (ROA) has a significant positive effect on tax avoidance, as measured by both ETR and BTD. This relationship holds across the overall sample ($\beta = -6.196952$, $p < 0.01$; $\beta = 1.902562$, $p < 0.05$), in the pre-COVID-19 period ($\beta = -8.355091$, $p < 0.01$; $\beta = 1.816753$, $p < 0.01$), and during the COVID-19 period ($\beta = -2.142188$, $p < 0.10$; $\beta = 1.893585$, $p < 0.01$). Firm size demonstrates mixed effects: when considering the overall data, it has a significant negative impact on tax avoidance measured by BTD ($\beta = -0.000912$, $p < 0.10$). However, before COVID-19, firm size exerts a positive influence on tax avoidance measured by ETR ($\beta = -0.028468$, $p < 0.10$), while during the pandemic it shows a negative effect on tax avoidance measured by BTD ($\beta = -0.000843$, $p < 0.10$). Leverage exhibits a consistent and significant negative effect on tax avoidance, with results significant for ETR in both the pre-COVID-19 ($\beta = 4.152996$, $p < 0.01$) and COVID-19 ($\beta = 2.443194$, $p < 0.01$) periods. Finally, financial constraints significantly increase tax avoidance, but only during the COVID-19 period, as reflected in ETR ($\beta = 0.00624$, $p < 0.05$). The R-

Square and adjusted R-Square values indicate values above 50% for various types of observation scenarios, both with ETR and BTD in various period scenarios. This indicates that this research model can explain tax avoidance by more than 50%.

Table 4. Regression Result

Variable	Overall		Before Covid-19		During Covid-19	
	ETR	BTD	ETR	BTD	ETR	BTD
ROA	-6.196952***	1.902562**	-8.355091***	1.816753***	-2.142188*	1.893585***
	-1,400,445	-0.031594	-2,895,892	-0.07705	-1,194,753	-0.050526
Size	-0.029878	-0.000912*	-0.028468*	−0.000067	-0.019017	-0.000843*
	-0.025944	-0.000495	-0.0146	-0.000388	-0.037846	-0.00049
LEV	0.93815	-0.028145	4.152996***	-0.028934	2.443194***	-0.026327
	-1,100,790	-0.020539	-0.669906	-0.017824	-0.814877	-0.020872
FIC	0.000231	−0.000033	0.000349	−0.0000061	0.006242**	−0.000022
	-0.001931	-0.000032	-0.000706	-0.000018	-0.002879	−0.000032
FAI	1,919,385	-0.138297**	3.907520*	-0.158907***	5,295,822	-0.143150*
	-3,195,863	-0.066039	-2,131,331	-0.056708	-3,198,810	-0.080588
Constant	0.259526	0.048726*	-2.691171***	0.028776	-1,697,189	0.045065
	-1,301,491	-0.02516	-0.807468	-0.021484	-1,343,941	-0.027801
R^2	0.722655	0.966545	0.545498	0.894051	0.944	0.961557
Adj. R^2	0.674259	0.965561	0.517784	0.887591	0.920131	0.959213

Note: ETR is the effective tax rate, BTD is the book tax difference, ROA is profitability, Size is firm size, LEV is leverage, FIC is financial constraint, and FAI is fixed asset intensity.
*p=10%; **p=5%; ***p=1%.

Source: Secondary data processed (2025)

Profitability and Tax Avoidance

The empirical analysis in Table 4 shows that profitability has a significant positive effect on tax avoidance, as measured by both ETR and BTD, across the full period as well as before and during the COVID-19 pandemic. When measured by ETR, the ROA coefficient is negative, indicating that higher profitability corresponds to lower effective tax rates and, therefore, more aggressive tax avoidance. In contrast, the ROA coefficient is positive when measured by BTD, suggesting a significant difference between accounting profit and taxable profit among highly profitable firms. According to Agency Theory, managers seek to reduce tax burdens in order to maximize net income for shareholders (Jensen & Meckling, 1976). Profitable firms with sufficient resources also have greater opportunities to employ tax consultants and exploit regulatory loopholes, thereby enhancing the effectiveness of tax strategies. Hossain et al. (2024) further emphasize that profitability is the most dominant determinant of tax avoidance. This study confirms earlier findings (Darsani & Sukartha, 2021; Hendayana et al., 2024; Suhada & Ryanto, 2025). These results show that even under the abnormal conditions of the COVID-19 pandemic, companies continued to rely on tax avoidance as a survival strategy to safeguard net profits. Thus, H1 is supported.

Company Size and Tax Avoidance

The results of the firm size analysis in Table 4 show mixed results. For the overall sample and during the COVID-19 period, firm size shows a significant negative effect on tax avoidance as measured by BTD. However, before the pandemic, firm size has a significant positive effect when measured by ETR. These differences indicate that tax behavior in large firms is shaped by environmental conditions, particularly the stability of the business climate. In the pre-COVID period, when conditions were more stable, larger firms may have leveraged economies of scale in tax planning, as reflected in the positive association with ETR. This aligns with Agency Theory, which suggests that managers in large companies exploit available resources to optimize tax planning for shareholder benefit. These findings are consistent with prior

research (Belz et al., 2019; Hossain et al., 2024; Sopiyana, 2022; Ulfa et al., 2021). By contrast, during the COVID-19 pandemic, larger firms faced greater cash flow pressures and appeared to focus on optimizing differences between commercial and taxable income (BTD) as a means of achieving tax savings (Sumaryati & Prawitasari, 2022). Therefore, H2 is partially supported, depending on the measurement proxy and the time period under consideration.

Leverage and Tax Avoidance

The findings also reveal that leverage has a significant negative effect on tax avoidance, both before and during the pandemic. This suggests that higher leverage ratios are associated with higher effective tax rates, reducing the scope for tax avoidance. Although debt financing is typically expected to lower tax burdens because interest expenses are deductible (Fuller et al., 2024), the results suggest otherwise: firms with higher debt levels actually paid more effective taxes. From an agency perspective, creditor pressure serves as an external control mechanism. Companies with substantial debt are subject to stricter monitoring, prompting them to comply more closely with tax regulations to maintain cash flow stability and creditor confidence. Interest expenses may also be relatively small compared to taxable income, limiting their effect on ETR. Firms with high leverage thus tend to operate more cautiously (Umar et al., 2021). These findings align with those of Oktafiani et al. (2023), Sari et al. (2021), and Vuong (2021). Furthermore, during the pandemic, tax incentives introduced by governments may have reduced firms' incentives to pursue aggressive avoidance strategies. Therefore, H3 is not supported.

Financial Constraints and Tax Avoidance

Table 4 also shows that financial constraints did not significantly influence tax avoidance before the pandemic but had a significant positive effect during it. The COVID-19 crisis intensified financial pressures, encouraging firms to adopt fiscal strategies, including tax avoidance, to relieve liquidity constraints. Firms in weaker financial positions tended to pay less tax as part of broader efforts to stabilize cash flow under limited financing options. This finding is consistent with Jin et al. (2022), who demonstrated the strong influence of financial constraints on avoidance behavior. In the banking sector, financially constrained firms have been shown to implement tax strategies to meet funding needs and enhance internal cash generation (Seidu et al., 2023). Tax avoidance is attractive under such conditions because it can free resources for operations, expansion, and research and development (Zhu et al., 2023). Similar findings are reported by Nabila and Rachmawati (2023) and Sun et al. (2023). Therefore, H4 is partially supported, as financial constraints positively affected tax avoidance only during the COVID-19 period.

Conclusion

The results confirm that internal financial characteristics play a critical role in shaping tax avoidance practices in Islamic banks across Asia. Profitability consistently shows a positive effect on tax avoidance before and during the COVID-19 pandemic. Firm size, however, is context-dependent: it positively affected tax avoidance (ETR) before the pandemic but had a negative effect (BTD) during the pandemic. Leverage exhibited a significant negative effect on tax avoidance in both periods, reflecting creditor monitoring and financial discipline. Financial constraints were insignificant before the pandemic but positively associated with avoidance during it, illustrating how external crises exacerbate firms' reliance on tax strategies.

This study offers several implications. Islamic bank management should balance funding strategies and capital structures to avoid overdependence on leverage. Firms with high profitability should ensure tax compliance to safeguard their reputations and sustain public trust. Regulators, meanwhile, should strengthen oversight and ethical monitoring of tax avoidance, particularly in times of economic instability, to secure tax revenues for social development. Importantly, tax compliance in Islamic banks should be viewed not only as a legal obligation but also as an ethical mandate rooted in *maqāṣid al-*

sharīʿah, which emphasizes justice and public benefit. While this study contributes to the literature, it is limited to financial characteristics. Future research could expand the analysis by incorporating ownership structure, family involvement in management, and the role of Sharia supervisory boards in influencing corporate tax behavior.

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