

Can Sharia-Compliance Protect the Financial Performance of Companies from the Effect of Value Added Tax

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Abstract

Sharia-compliant companies differ from other companies in its financing sources and business activities. These differences may affect its ability to protect its financial performance from changes in tax policies. The main queries in this study were whether value-added tax can affect the financial performance of companies and whether sharia-compliance can mitigate that effect. To answer these queries, a quantitative research method was utilized using data about listed companies in Abu Dhabi stock exchange in the United Arab Emirates. Data were collected from the financial reports of the listed companies for two years before the imposing of VAT in UAE (2016, 2017) and for two years after the VAT imposition and before the pandemic of COVID-19 (2018, 2019). Collected data were used to calculate financial ratios for the included companies first and then these ratios were further analyzed using Nonparametric regression. Conclusions of this study indicated that VAT had a negative and insignificant effect on the financial performance of all companies while this effect is positive and insignificant for Sharia-non-compliant companies implying that Sharia-compliance cannot mitigate the negative effect of VAT.

Keywords: Sharia-compliance, value-added tax, financial performance, UAE

1. Introduction

Financial performance of companies can be affected by many variables including tax rates because it can impact the debt cost and thus affect profitability (Ullah et al., 2020); in addition, value-added tax (VAT) can affect financial performance when tax incentives are given to some companies as explained by Sun et al. (2020). The problem is that VAT can negatively affect the financial performance of the companies (Otaibi et al. 2024; Sun et al., 2020) which may lead to negative consequences on the entire economy. The specific problem is that it's unknown how to protect the financial performance of companies from the negative impact of imposing VAT as the prices of goods and services are expected to increase after the VAT increase (Benzarti et al., 2020) causing a fall in sales and profitability. The proposed protection method in this study was Sharia-compliance and the main objective was to test whether this compliance can really protect the financial performance of companies from the negative effects of VAT. Because VAT is paid by the last consumer, it may decrease the purchasing power of people with limited budgets resulting in less purchases than before and thus lowering sales and profits ratios for the companies. In addition, some companies sell on credit which means that customers will pay later while the company should pay VAT within a short period which may result in a big gap between cash inflows and outflows leaving the company with a shortage of cash. This cash shortage enforces the company to search for some external sources of financing including loans and this affects the debt utilization ratios which are part of financial performance measures. In addition to VAT, many other variables can impact financial performance including the company size (Ertiro & Mohammed, 2022) and inflation rate (Nugraha et al., 2021) which are included in this study as control variables.

The impact of VAT on the financial performance of companies was studied by some researchers including Al-Otaibi et al. (2024) who studied the impact of imposing new VAT on the financial performance of listed non-financial companies in Saudi Arabia. They concluded that the imposition of VAT had a negative effect on the financial performance measured by some indicators like total revenues, total expenses, shareholders' equity, and net income. The negative effect of VAT on the financial performance was evidenced also by Ezuem and Sagbara (2024) while Oduori et al. (2024) claimed that VAT incentives can enhance the financial performance of companies. As imposing VAT for the first time can have negative effects on financial performance, companies

should search for a protection shield to maintain their financial performance and achieve sustainable growth. The proposed way in this study to achieve that goal is following Sharia rules in doing business. Many researchers concluded that financial limitations confronted by companies can be overcome through Sharia compliance (Guizani & Abdalkrim, 2022) and high tax payments can increase the likelihood of increasing financial performance of Islamic organizations that follows Sharia law (Munandar, 2021); these findings indicate that Sharia compliance can help companies in reducing financial constraints and enhance their financial performance. Based on this, it can be said that Sharia compliance may protect the financial performance of companies from the negative effects of the first-time imposition of VAT and testing this claim was the main objective behind this study. This study can add value to the existing literature by introducing a new way to mitigate the negative effects of VAT on the financial performance of companies; this way has not been studied and tested before. Conclusions of this study are of great benefit to companies operating in countries where the VAT is imposed or planned to be imposed for the first time. If Sharia-compliance is concluded to be an effective way to protect the financial performance of companies from the effects of VAT, companies can plan for changing their operation, policies and procedures to be Sharia-compliant and they even can predict what their financial performance will look like after imposing VAT. In addition, tax authorities may determine the time of imposing or increasing VAT based on the number of companies that follow Sharia rules and promoting Sharia-compliance before imposing or increasing VAT. The major hypothesis tested in this study was that Sharia-compliance can protect the financial performance of companies from the negative effects of imposing VAT for the first time.

2. Literature Review

2.1 Financial Performance and Its Determinants

Financial performance is the capability of the company to manage and control its available resources as explained by Gharbi and Jarboui (2024), these resources include, among others: cash, other current and non-current assets, debt, other liabilities, and owners' equity. Financial performance includes also profitability because it represents an indication for the successful management of resources. Financial performance can be measured using accounting-based measures, market-based measures, and mixed methods based on both: market and accounting. Accounting based measures are ratios calculated using information in financial statements while market-based measures are calculated using market information which makes it inapplicable for non-listed companies (Partalidou et al., 2020). Although accounting-based measures suffer from some limitations like the use of misstated accounting numbers and inconsistency of adopted accounting principles (Faello, 2015), it was used in this study because it reflects the internal performance perspective and not the market perspective (in the market-based measures) about financial performance of the company. In addition, market evaluation for the company considers many variables and not only the financial performance of the company. Financial ratios used in this study included: current ratio, cash ratio, debt ratio, interest coverage ratio, asset turnover ratio, inventory turnover ratio, gross margin ratio, return on assets ratio, operating cashflow ratio, cashflow coverage ratio, and cashflow to net income ratio.

The determinants of financial performance were studied by many researchers; among these determinants was the gross domestic product (GDP) (Akande et al., 2021), liquidity (Purwohandoko & Iriani, 2021), export growth (Ullah et al., 2020), company size (Ertiro & Mohammed, 2022), and inflation rate (Nugraha et al., 2021). GDP was studied in insurance companies by Akande et al. (2021) and was concluded to have a significant effect on the financial performance while liquidity effect was studied in banks and claimed to have no effect on its financial performance (Purwohandoko & Iriani, 2021). Export growth can affect the financial performance of companies operating in the textile industry as concluded by Ullah et al. (2020). In addition, inflation rate when combined with company size and leverage was concluded to have a significant effect on the financial performance of plantation companies (Nugraha et al., 2021). In this study, however, included companies were all listed non-financial companies in Abu Dhabi exchange which means that all financial companies including banks and insurance firms were excluded and based on this, variables that were concluded to influence the financial performance of these companies (GDP and liquidity) were not included in this study. Moreover, export growth was excluded from the model of this study because it was claimed to impact on only companies operating in a specific industry with specific characteristics and not all listed companies. To sum up, the variables that were included in this study as variables that can affect financial performance in addition to VAT were only the company size and inflation rate.

2.2 Impact of Taxes on Financial Performance

Taxes play a vital role in determining the level of the financial performance of companies as concluded by Aringo (2023) who claimed that direct and indirect taxes can negatively affect the financial performance of

companies while tax incentives can enhance that performance. Taxes are additional costs that can affect the profitability of companies (Ullah et al., 2020); this effect exists even for small and medium enterprises which have a significant contribution to the development of current economies (Adewara et al., 2023; Picas et al., 2021). Taxes can impact financial performance by increasing tax payable (VAT payable and corporate tax payable) which leads to decrease some performance indicators like the current ratio and cash ratio while cash payment of taxes reduce the available cash for companies to invest in profitable projects that increase return on assets and return on equity. In addition, companies need more cash to pay corporate tax and VAT which may cause liquidity problems especially when they sell on credit and pay taxes in cash. These liquidity problems may push companies to take loans and negatively impact their cash flow management which consequently affect some performance ratios like debt ratio, interest coverage ratio, cashflow coverage ratio, and cashflow-to-net income ratio. Based on these hypothesized effects, it can be said that imposing and increasing tax rates can have a negative impact on financial performance although the contrary has been concluded in few cases like the case of electronic industry (Matero & Lee, 2024).

VAT can negatively affect the profitability of companies (Qavami et al., 2022) and consequently their financial performance. VAT negatively impacts the profitability of businesses through increasing the admin costs required to manage VAT related reporting and bookkeeping and through the cost of keeping financial records for the legal period required by VAT regulations (*Vat Impact On Company*, n.d.). Both VAT and COVID-19 pandemic have negatively impacted the financial performance of companies in Saudi Arabia in which VAT was imposed for the first time in 2020. VAT effect was evidenced by decreasing in total revenues, net income, and cash at the end of the period as concluded by Al-Otaibi et al. (2024). This negative effect, however, may not exist in some industries like telecommunication industry where VAT has a positive effect on the financial performance (Gachigo, 2024). To sum up, the negative effect of imposing taxes on financial performance was evidenced in many studies although few researchers claimed a positive effect on the financial performance of companies operating in specific industries like telecommunication and electronic which may be caused by the specific attributes of these industries or because of some methodological limitations in these studies.

2.3 Sharia-Compliance and VAT

Sharia is the Islamic principles that rule all activities of Muslims and Islamic organizations; it's the control over social, economic and political relationships in Islamic community (*Sharia*, 2025). These principles were used to categorize listed companies in many stock exchanges all over the world into two groups: Islamic-compliant companies and Islamic non-compliant companies; these same groups exist in Abu Dhabi security exchange (ADX) in the United Arab Emirates (UAE). The screening criteria of companies in ADX is based on the criteria set in sharia standards issued by the accounting and auditing organization for Islamic financial institutions (AAOIFI) as interpreted by the internal sharia supervisory committees in the relevant financial institutions in UAE. The criteria for companies to be considered Sharia-compliant companies include four compliance filters and one tradability filter (Habib & Faruq Ahmad, 2017; *SS (21) Financial*, 2023). The first filter states that the main or core business of the listed company should be permissible by Islam; the prohibited businesses include business based on Riba (usury), trading in uncertainty (gharar), gambling, and manufacturing or trading of prohibited goods and services like liquor and pork. The second filter is that the total prohibited income should not exceed 5% of the total income of the company while the third filter states that the interest taking deposits should not exceed 30% of the market capitalization of total equity. In the fourth filter, its stated that interest bearing debt should be equal to or less than 30% of the market capitalization of the corporation. The tradability filter states that the total market value of illiquid assets should not be less than 30% of the market value of total assets (Habib & Faruq Ahmad, 2017). This last filter is not a criterion to filter Sharia-compliant companies but a criterion to ensure that trading in the shares of the company in the Sharia-compliant list does not become another kind of sharia transactions which requires following different Sharia rules than the rules of shares trading (like rules of Sarf) (Habib & Faruq Ahmad, 2017; *SS (21) Financial*, 2023).

Sharia-compliance can enhance the financial performance of sharia-compliant companies although these companies follow stricter rules than the non-compliant companies (Akguc & Al Rahahleh, 2018; Boulanouar et al., 2024; Pepis & de Jong, 2019; Saba et al., 2021). Sharia-compliance filters reduce the available resources for investment in sharia-compliant companies which push the companies to make wiser and more careful investment decisions that enhance their performance and increase their profitability (Boulanouar et al., 2024). In addition, Sharia-compliant firms are less risky and more flexible (Cheong, 2021) which may make it a good choice for all investors regardless of their religion and that will lead to more financial stability and profitability as the financial resources will be always available for these firms from investors. Another attribute of sharia-compliant firms that drives better financial performance is that these firms have a better operational performance as concluded by

Akguc and Al Rahahleh (2018); this better operational performance leads to better profit and better assets turnover (Akguc & Al Rahahleh, 2018) which means a better financial performance. Based on the discussion in the previous section (impact of taxes on financial performance) about the negative effect of VAT on the financial performance and the discussion in this section about the better financial performance of sharia-compliant firms compared to sharia non-compliant ones, I conducted this study to test whether sharia-compliance can really protect companies from the negative effect of VAT. In other words, the main objective behind this study was to test if sharia-compliant firms have a stronger shield that can help them avoid the negative impacts of VAT on their financial performance. The value that this study can add to the literature is derived from being the first study to test if sharia-compliance matters regarding the negative effects of VAT on the financial performance of non-financial companies. In addition, this study is important because if Sharia compliance is approved to be a good shield against the negative effects of VAT on financial performance, then companies all over the world can use it to maintain its performance during the periods of imposing new VAT or increasing its rate. Based on the previous discussion, it's hypothesized in this study that VAT negative effect on the financial performance of Sharia-compliant companies is significantly less than that on non-sharia-compliant companies.

2.4 Hypotheses

Because taxes in general have a negative impact on financial performance (Adewara et al., 2023; Aringo, 2023; Picas et al., 2021; Ullah et al., 2020) and because VAT specifically can also negatively affect the financial performance (Al-Otaibi et al., 2024; Qavami et al., 2022; *Vat Impact On Company*, n.d.), the first three hypotheses in this study were developed as follows:

H1.1: There is a negative and significant relationship between financial performance and VAT in all companies.

H1.2: There is a negative and significant relationship between financial performance and VAT in Sharia-compliant companies.

H1.3: There is a negative and significant relationship between financial performance and VAT in Sharia-non-compliant companies.

As Sharia compliance was evidenced to have a positive impact on the financial performance (Akguc & Al Rahahleh, 2018; Boulanouar et al., 2024; Pepis & de Jong, 2019; Saba et al., 2021) it may protect companies from the negative effects of VAT on their financial performance and based on this, the following hypothesis was formulated:

H2: The negative relationship between VAT and financial performance is weaker for Sharia-compliant companies than for Sharia-non-compliant companies.

These hypotheses were tested by first calculating financial ratios based on the financial data available in Abu Dhabi security exchange (ADX) for the years 2016 to 2019 and then use non-parametric regression as the main test.

3. Method

3.1 Research Data

The independent variable of this study was the financial performance of all companies listed in ADX during the years 2016-2019 except for companies in the financial sector because it has special attributes and special financial performance indicators. The number of these companies was 31 companies of which 17 companies were Sharia-compliant and 14 companies were Sharia-non-compliant. Financial performance was measured by calculating the average of the following ratios: current ratio, cash ratio, debt ratio, interest coverage ratio, asset turnover ratio, inventory turnover ratio, gross margin ratio, return on assets ratio, operating cashflow ratio, cashflow coverage ratio, and cashflow to net income ratio. The dependent variables were the size of the company which was measured using the natural logarithm of total assets, inflation rate for which the measure used was "inflation, consumer prices %" which is issued by the world bank, and the VAT which was added to the model as zero for years before the VAT and one After the VAT. Because VAT was started in UAE on January 1, 2018 at a rate of 5% (United Arab Emirates Ministry of Finance, n.d.), years of 2016 and 2017 were considered before the VAT and years 2018 and 2019 were considered as after VAT. Size and inflation rate were added as control variables because it was claimed by many researchers to have an effect the financial performance (Ertiro & Mohammed, 2022; Nugraha et al., 2021). Financial statements that were used to calculate the financial ratios and size were downloaded from the ADX website (<https://www.adx.ae>) while data of inflation rate were downloaded from the website of the world bank (<https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>). All data were downloaded for four years: two years before imposing VAT in UAE (2016, 2017) and two years after imposing VAT (2018,2019).

3.2 Research Design

The research design of this study was a quantitative design using two kinds of data: ready data about the dependent variable of inflation rate and calculated data about two variables: the firm's size which was measured using the natural logarithm of total assets and the financial performance of each company which was measured as follows:

$$\frac{\sum \text{Ratios}}{n} \quad (1)$$

Where Ratios are the calculated current ratio, cash ratio, debt ratio, interest coverage ratio, asset turnover ratio, inventory turnover ratio, gross margin ratio, return on assets ratio, operating cashflow ratio, cashflow coverage ratio, and cashflow to net income ratio. n: is the number of ratios which was 11. This average was calculated for each company in the population for the years 2016 – 2019. After calculating the average ratios for each company, the control variable of size was added to the model and then the inflation rate for the covered four years. At the end, the variables used for the analysis were: financial performance (ratios average) for each firm for four years, size of the company (Ln of total assets) for each firm for four years, inflation rate repeated for all the firms for each year of four years, and VAT that takes the value of zero for the years 2016 and 2017 and one for the years 2018 and 2019. For each firm, four variables were included in the model, financial performance, size of firm, inflation rate (the same for all firms in each year), and VAT (zero and one). To test whether there is a significant difference between sharia-compliant and sharia-non-compliant companies in terms of VAT effect, another variable was added to the model which has the value of zero if the company is non-sharia-compliant and one if it's sharia-compliant. After that, the same model was used to test the data of sharia-compliant and non-sharia-compliant companies separately. The best statistical test that can be used to test the relationship between independent and dependent variables while controlling for other variables is the linear multiple regression which was intended to be used in this study but because the assumptions of this test were not met, the non-parametric regression was used. The statistical software used was Stata 15. All tests were conducted after cleaning the data from outliers.

3.3 Financial Ratios

As mentioned before, the financial performance of companies was measured using the average of a group of financial ratios; these financial ratios were calculated as follows (*Financial Ratios*, 2025; Lee, 2024):

$$\text{Current ratio} = \text{Current assets} / \text{Current liabilities} \quad (2)$$

$$\text{Cash ratio} = \text{Cash and Cash equivalents} / \text{Current Liabilities} \quad (3)$$

$$\text{Debt ratio} = \text{Total liabilities} / \text{Total assets} \quad (4)$$

$$\text{Interest coverage ratio} = \text{Operating income} / \text{Interest expenses} \quad (5)$$

$$\text{Asset turnover ratio} = \text{Net sales} / \text{Average total assets} \quad (6)$$

$$\text{Inventory turnover ratio} = \text{Cost of goods sold} / \text{Average inventory} \quad (7)$$

$$\text{Gross margin ratio} = \text{Gross profit} / \text{Net sales} \quad (8)$$

$$\text{Return on assets ratio} = \text{Net income} / \text{Total assets} \quad (9)$$

$$\text{Operating cash flow ratio} = \text{Operating cash flow} / \text{Current liabilities} \quad (10)$$

$$\text{Cash flow coverage ratio} = \text{net cash flow from operations} / \text{total debt} \quad (11)$$

$$\text{Cash flow to net income} = \text{cash flow from operating activities (CFO)} / \text{net income} \quad (12)$$

Other financial performance ratios like the accounts receivable turnover were not included because it needs information not available in the financial statements of the included companies.

4. Results

4.1 Descriptive Statistics

Descriptive statistics about the variables of the study are summarized in Table 1. It can be noticed from this table that the total averages of financial performance before imposing VAT (2016 and 2017) which was 6.421 is greater than the total averages after VAT (2018 and 2019) which was 4.367. This indicates that the financial performance of listed companies declined after the imposing of VAT in UAE. In addition, it can be noticed that the inflation rate has no standard deviation (SD) and this is because the rate was the same for all companies for each year. Finally, the size for included companies was almost the same before and after VAT imposition.

Table 1. Descriptive Statistics for the Variables of: Financial Performance, Inflation Rate, and Size of the Company for the Years 2016 to 2019

Details / Year	2016	2017	2018	2019
	Average (SD)	Average (SD)	Average (SD)	Average (SD)
Financial performance	2.892 (3.035)	3.529 (5.748)	2.031 (5.630)	2.336 (4.750)
Inflation rate	1.617	1.967	3.069	-1.931
Size of company	21.829 (1.583)	21.642 (1.585)	21.612 (1.600)	21.638 (1.626)

Table 2 provides more details about the study variables for sharia-compliant and non-sharia-compliant companies. The table shows that the financial performance of Sharia-compliant companies was greater than that for sharia-non-complaint companies for all covered years but the financial performance of Sharia-compliant companies declined after VAT and the financial performance of Sharia-non-compliant companies increased after the imposing of VAT. In addition, the average size of Sharia-compliant and Sharia-non-compliant companies was almost the same during the included years.

Table 2. Descriptive Statistics for the Variables of: Financial Performance, Inflation Rate, and Size of the Company for the Years 2016 to 2019 for sharia-compliant and sharia-non-compliant companies separately

Year / Details	Financial performance		Inflation rate		Size of company	
	Sharia	Non-Sharia	Sharia	Non-Sharia	Sharia	Non-Sharia
2016 Average (SD)	3.090 (2.372)	2.651 (3.669)	1.617	1.617	22.157 (1.244)	21.430 (1.838)
2017 Average (SD)	7.334 (12.027)	-1.847 (14.166)	1.967	1.967	22.168 (1.260)	21.005 (1.700)
2018 Average (SD)	2.810 (4.006)	1.086 (7.005)	3.069	3.069	22.118 (1.277)	20.998 (1.732)
2019 Average (SD)	3.204 (5.583)	1.282 (3.174)	-1.931	-1.931	22.144 (1.299)	21.024 (1.766)

4.2 Hypotheses Testing

As many researchers concluded that VAT has a negative impact on the financial performance of companies, the first hypothesis in this study was formulated to test whether this negative impact exists in the listed companies in ADX. Furthermore, the main objective of this study was to determine whether the negative impact is different in Sharia-compliant and Sharia-non-compliant companies and this requires testing if the effect exists in these two kinds of companies. Based on this, the first hypothesis was developed to contain three sub-hypotheses: one to test the existence of the negative impact, another one to test that impact in Sharia-compliant companies, and the third one to test the impact on Sharia-non-compliant companies. these hypotheses were as follows:

H1.1: There is a negative and significant relationship between financial performance and VAT in all companies.

H1.2: There is a negative and significant relationship between financial performance and VAT in Sharia-compliant companies.

H1.3: There is a negative and significant relationship between financial performance and VAT in Sharia-non-compliant companies.

As mentioned before, the linear multiple regression was planned to be used to test these hypotheses but because the assumptions of this test were violated, the non-parametric regression was used after cleaning the data from outliers by replacing the outliers with the median of other values for the same variable excluding the outlier itself. The results of the non-parametric regression for hypothesis H1.1 are summarized in Table 3. These results show that the control variables of inflation rate and size had a positive but insignificant impact on financial

performance while VAT has a negative and insignificant effect on the financial performance of all included companies (observed estimate = -3.921, $p = .477$). In addition, the variable of Sharia-compliance was insignificant at 5% level ($p = .232$) indicating that the difference between Sharia-compliant and non-compliant companies in terms of VAT effect is insignificant. To sum up, VAT has a negative but insignificant impact on the financial performance of all included companies which means that hypothesis H1.1 cannot be accepted.

Table 3. Results of non-parametric Regression for Hypothesis H1.1

Variable	Observed estimate	<i>P</i> value
Inflation rate	2.013	.602
Size	0.101	.806
VAT	-3.921	.477
Sharia compliance	1.533	.232
R squared	.166	

An additional non-parametric regression was run to test the effect of VAT on each calculated financial ratio and the results are shown in Table 4. The results indicated that all variables for all ratios were insignificant except for the size variable which had a significant negative effect on the debt ratio. In addition, all variables including VAT had negative effect on some ratios and a positive effect on others; VAT had a positive effect on current ratio, debt ratio, asset turnover ratio, inventory turnover ratio, and cashflow coverage ratio while it had a negative impact on the rest of ratios. Finally, VAT had a negative but insignificant impact on two out of three cashflow ratios.

Table 4. Results of non-parametric Regression for Hypothesis H1.1 Ratio wise- all Companies

Ratio	Inflation rate		Size		VAT	
	Observed estimate	<i>P</i> value	Observed estimate	<i>P</i> value	Observed estimate	<i>P</i> value
Current ratio	-0.432	.668	-0.100	.549	0.470	.700
Cash ratio	0.370	.747	-0.169	.302	-0.615	.678
Debt ratio	-0.022	.834	0.042	.019	0.060	.671
Interest coverage ratio	9.896	.676	3.686	.310	-27.676	.412
Asset turnover ratio	-0.091	.485	-0.003	.870	0.078	.650
Inventory turnover ratio	-7.426	.870	0.182	.953	6.848	.906
Gross margin ratio	-0.022	.870	-0.032	.213	-0.004	.980
Return on assets ratio	0.051	.383	0.002	.774	-0.085	.227
Operating cash flow ratio	0.007	.988	-0.026	.714	-0.056	.928
Cash flow coverage ratio	-0.359	.396	0.027	.619	0.328	.555
Cash flow to net income	-0.113	.959	0.208	.279	-0.308	.915

Regarding hypothesis H1.2, the results shown in Table 5 indicate that the relationship between the control variable of inflation rate and the financial performance of Sharia-compliant companies was positive but insignificant at 5% level of significance while the relationship between financial performance and size was negative and insignificant. VAT impact on the financial performance of Sharia-compliant companies was negative and insignificant (observed estimate = -7.696, $p = .377$) which means that hypothesis H1.2 cannot be accepted.

Table 5. Results of non-parametric Regression for Hypothesis H1.2 (Sharia-compliant companies)

Variable	Observed estimate	P value
Inflation rate	5.111	.389
Size	-1.307	.344
VAT	-7.696	.377
R squared	.163	

An additional non-parametric regression was run for this hypothesis considering each ratio separately in the same way as hypothesis H1.1. The results of this additional regression are summarized in Table 6. It can be seen in Table 6 that all independent variables including VAT were insignificant with positive effect for some ratios and negative effect for others. The most important variable here is VAT which had a negative effect on the current ratio, gross margin ratio, return on asset ratio, operating cash flow ratio, and cash flow to net income ratio. VAT had a negative impact on gross margin ratio, return on asset ratio, operating cash flow ratio, and cash flow to net income ratio in the included companies considered together and in Sharia-compliant companies separately. The cash ratio and interest coverage ratio were affected negatively by imposing VAT in the entire set of companies but affected positively in the Sharia-compliant companies.

Table 6. Results of non-parametric Regression for Hypothesis H1.2 Ratio wise – Sharia-compliant Companies

Ratio	Inflation rate		Size		VAT	
	Observed estimate	P value	Observed estimate	P value	Observed estimate	P value
Current ratio	-0.080	.925	-0.201	.300	-0.020	.986
Cash ratio	-0.236	.714	-0.027	.839	0.321	.679
Debt ratio	-0.042	.793	0.068	.052	0.080	.700
Interest coverage ratio	-15.769	.489	2.045	.684	12.429	.669
Asset turnover ratio	-0.066	.752	-0.033	.389	0.042	.878
Inventory turnover ratio	-1.299	.895	1.336	.737	13.123	.407
Gross margin ratio	0.022	.903	0.053	.071	-0.049	.843
Return on assets ratio	0.034	.469	0.013	.177	-0.069	.231
Operating cash flow ratio	0.098	.797	0.116	.131	-1.632	.739
Cash flow coverage ratio	-0.450	.440	0.143	.230	0.335	.657
Cash flow to net income	0.567	.787	0.199	.581	-1.269	.655

The last sub-hypothesis for hypotheses one was H1.3 which is the same as H1.2 but for Sharia-non-compliant companies. The results of testing this hypothesis are illustrated in Table 7. The results revealed that all the variables had the opposite direction for the results of hypothesis H1.2 and all of it were insignificant too. The inflation effect on the financial performance of Sharia-non-compliant companies is opposite to that in Sharia-compliant companies as it was negative for the former and positive for the latter and the same can be said about size which had a negative impact in Sharia-compliant companies but a positive impact in Sharia-non-compliant companies. Regarding the VAT, its impact on financial performance of Sharia-non-compliant companies was positive and insignificant which means that hypothesis H1.3 cannot be accepted. Based on this, it can be said that VAT has a positive but insignificant effect on the financial performance of Sharia-non-compliant companies.

Table 7. Results of non-parametric Regression for Hypothesis H1.3 (Sharia-non-compliant companies)

Variable	Observed estimate	P value
Inflation rate	-2.234	.539
Size	0.285	.490
VAT	3.117	.488
R squared	.177	

Once again, a non-parametric regression for ratios separately was run for this hypothesis like the other sub-hypotheses. The results of this regression are summarized in Table 8.

Table 8. Results of non-parametric Regression for Hypothesis H1.3 Ratio wise – Sharia-non-compliant Companies

Ratio	Inflation rate		Size		VAT	
	Observed estimate	P value	Observed estimate	P value	Observed estimate	P value
Current ratio	-0.764	.728	-0.036	.853	.988	.718
Cash ratio	-0.664	.765	-0.118	.508	0.764	.784
Debt ratio	0.016	.930	0.044	.261	-0.011	.970
Interest coverage ratio	-0.401	.934	0.568	.529	1.091	.901
Asset turnover ratio	-0.121	.548	0.011	.709	0.128	.653
Inventory turnover ratio	7.751	.590	1.547	.420	-10.254	.570
Gross margin ratio	-0.039	.914	-0.094	.064	0.021	.971
Return on assets ratio	-0.015	.874	-0.005	.734	-0.003	.989
Operating cash flow ratio	-0.031	.970	0.002	.979	-0.012	.992
Cash flow coverage ratio	-0.019	.956	0.017	.656	-0.108	.814
Cash flow to net income	2.774	.423	0.304	.581	-3.120	.564

As can be noticed from Table 8, all independent variables for all ratios were insignificant at 5% level of significance. In addition, VAT had a negative effect on return on assets ratio, operating cash flow ratio, and cash flow to net income ratio which is the same effect for Sharia-compliant companies. The difference in VAT effect for Sharia-compliant and sharia – non-compliant companies was in debt ratio, inventory turnover ratio, and cash flow coverage ratio. This means that Sharia-compliance can protect the financial performance measured by debt ratio, inventory turnover ratio, and cash flow coverage ratio if the effect was significant.

Finally, as the effect of VAT on the financial performance of Sharia-non-compliance companies was positive, the following last hypothesis was not tested.

H2: The negative relationship between VAT and financial performance is weaker for Sharia-compliant companies than for Sharia-non-compliant companies

5. Conclusion

Based on the statistical results summarized in sections 4.1 and 4.2., it can be said that VAT has a negative effect on the financial performance of Sharia-compliant companies while this effect is positive for Sharia-non-compliant companies and the impact is insignificant in both cases. When analyzed ratio wise, the results also were insignificant with the following ratios being negative for non-compliant companies and positive for sharia-compliant companies: debt ratio, inventory turnover ratio, and cash flow coverage ratio. These results indicate that Sharia-compliance cannot protect financial performance of companies from the negative effect of VAT. Results regarding the control variables of size and inflation rate revealed that they both had a positive insignificant effect on the financial performance of companies. Results about size are in line with the conclusion

of Ertiro & Mohammed (2022) which indicated the same positive and insignificant effect. In addition, results about inflation rate are the same reached by Febriyanti et al. (2024) in terms of the positive effect but opposite to it in terms of significance. Results about VAT in this study indicated that it has a negative but insignificant effect on the financial performance of companies which supports the conclusions of many studies (Al-Otaibi et al. 2024; Qavami et al., 2022) and its opposite to the results of Gachigo (2024). Finally, the claim that Sharia-compliance can enhance the financial performance of companies seems to be incorrect in UAE market as the results indicated that financial performance of Sharia-non-compliant companies was enhanced after the VAT and financial performance of Sharia-compliant companies decreased during the same period. These last results about Sharia-compliance do not support the conclusions of most of previous studies (Akguc & Al Rahahleh, 2018; Boulanouar et al., 2024; Pepis & de Jong, 2019; Saba et al., 2021). One suggested reason behind these different results is the methodology followed in this study regarding the measurement of financial performance, method of processing the data, and the statistical test used. Previous studies use different measures of financial statements and usually its one or two ratios while in this study, the term was made wider encompassing 11 financial ratios instead of one or two.

Based on the data used and companies covered, the results of this study can be generalized to other similar countries especially the countries of the gulf cooperation council (GCC). ADX market can be considered a representative financial market for other markets in the region because it includes big companies operating in the same environment as the other GCC countries. This study represents the first attempt to identify the role of Sharia-compliance in mitigating the negative impact of VAT on the financial performance, all other studies were trying to determine the effect of Sharia-compliance on enhancing the financial performance in general and this is the standpoint of the value of this study. The results of this study can be of great benefit to tax authorities to plan taxes prior to imposing it for the first time or increase its rate. In addition, the conclusions may help investors evaluate the stocks of companies after the imposing of new VAT or after the gradual increase in its rate. In addition, market management may cooperate with tax authorities when a new VAT plan is suggested by inputting the expected financial performance data after the new VAT. These benefits open the door for more research projects about the suggested solutions for the effects of VAT on financial performance. In fact, future research can be conducted to test the role of variables like companies' sector, foreign ownership, and corporate governance in protecting the financial performance of companies from the negative impact of VAT.

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Competing interests

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Data sharing statement

No additional data are available.

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