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JTH TAX, INC. AND SUBSIDIARIES

(d/b/a Liberty Tax Service)

Consolidated Financial Statements

April 30, 2006, 2005 and 2004

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
2100 Dominion Tower
999 Waterside Drive
Norfolk, VA 23510

Independent Auditors' Report

The Board of Directors and Stockholders
JTH Tax, Inc.:

We have audited the accompanying consolidated balance sheets of JTH Tax, Inc. (d/b/a Liberty Tax Service) and subsidiaries (the Company) as of April 30, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended April 30, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of JTH Tax, Inc. and subsidiaries as of April 30, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended April 30, 2006, in conformity with U.S. generally accepted accounting principles.

Effective December 31, 2003, the Company implemented the provisions of Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities, and Interpretation of Accounting Research Bulletin No. 51*, as described in note 1(b).

Effective May 1, 2005, the Company implemented the provisions of Financial Accounting Standards Board Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* as described in note 10 (c).

KPMG LLP

Norfolk, Virginia
August 4, 2006

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)
Consolidated Balance Sheets
April 30, 2006 and 2005

Assets (Notes 5, 7 and 8)		2006	2005
Current assets:			
Cash and cash equivalents	$	13,422,348	7,035,148
Short-term investments		68,775	71,989
Receivables (notes 2 and 12):			
Trade accounts		15,905,246	10,691,755
Notes		26,100,362	21,419,124
Refund anticipation loan fees, net		3,302,751	2,692,938
Interest		1,673,545	1,735,754
Allowance for uncollectible amounts		(2,022,887)	(2,036,558)
Total receivables, net		44,959,017	34,503,013
Inventory		711,819	1,326,225
Prepaid expenses and other current assets		898,328	1,715,129
Deferred income taxes (note 9)		2,274,496	1,092,421
Total current assets		62,334,783	45,743,925
Property, equipment and software, net (notes 3 and 6)		9,037,699	7,042,927
Notes receivable, excluding current portion, net of allowance for uncollectible amounts of $1,060,534 and $707,264 for 2006 and 2005, respectively (notes 2 and 12)		21,545,731	18,964,765
Goodwill		1,913,028	1,913,028
Other intangible assets, net (note 4)		3,780,794	2,136,033
Restricted cash		189,561	185,321
Other assets		902,620	1,169,985
Total assets	$	99,704,216	77,155,984
Liabilities, Minority Interest and Stockholders' Equity			
Current liabilities:			
Current installments of long-term debt (notes 7)	$	846,894	987,699
Current installments of obligations under capital leases (note 6)		35,574	85,442
Accounts payable and accrued expenses (notes 12 and 14)		17,639,674	10,804,369
Income taxes payable		12,101,263	8,692,523
Deferred franchise fees (note 12)		7,679,708	5,418,268
Franchise deposits		72,035	137,302
Total current liabilities		38,375,148	26,125,603
Long-term debt, excluding current installments (note 7)		1,104,308	1,634,682
Obligations under capital leases, excluding current installments (note 6)		13,253	48,828
Other long-term liabilities (note 14)		75,027	75,027
Subordinated debt (note 8)		15,853,079	15,226,121
Deferred income taxes (note 9)		1,676,880	1,174,564
Total liabilities		57,097,695	44,284,825
Minority interest		20,452	—
Stockholders' equity (notes 10 and 11):			
Preferred stock		2,872,742	2,872,742
Special voting preferred stock		10	10
Common stock		6,229,263	5,950,853
Exchangeable shares		100,000	100,000
Common stock committed to be issued		16,000	32,000
Put warrants		—	1,679,578
Additional paid-in capital		12,461,781	9,595,083
Treasury stock, at cost		(1,428,000)	(1,288,000)
Accumulated other comprehensive income		338,824	205,144
Retained earnings		21,995,449	13,723,749
Total stockholders' equity		42,586,069	32,871,159
Commitments, contingencies and subsequent events (notes 2, 5, 6, 14 and 15)			
Total liabilities, minority interest and stockholders' equity	$	99,704,216	77,155,984

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statements of Income

Years ended April 30, 2006, 2005 and 2004

	2006	2005	2004
Revenues (note 12):			
Franchise fees, net of provision for franchise fee refunds of $1,330,004 in 2006, $1,730,029 in 2005, and $1,669,209 in 2004	$ 23,561,430	19,491,810	17,771,410
Royalties and advertising fees	16,761,528	12,634,833	11,752,150
Bank product and tax discounting income	14,919,392	11,428,239	8,535,556
Interest income	4,860,912	4,747,360	2,561,973
Tax preparation fees, net of discounts	4,828,569	1,498,041	912,853
Gain on sale of intangibles and property and equipment, net	106,723	227,941	146,947
Other revenue	1,113,992	982,584	529,888
Total revenue	66,152,546	51,010,808	42,210,777
Operating expenses:			
Employee compensation and benefits	14,823,206	11,770,454	10,039,590
General and administrative expenses (note 6)	20,585,896	16,067,387	14,555,598
Advertising expense	8,019,131	6,809,370	6,609,504
Interest expense	3,067,898	2,320,532	807,857
Depreciation, amortization and impairment charges (notes 3 and 4)	2,213,306	1,564,927	1,558,053
Total operating expenses	48,709,437	38,532,670	33,570,602
Other, net	(404,741)	288,229	25,996
Income before income taxes and cumulative effect of accounting change	17,038,368	12,766,367	8,666,171
Income tax expense (note 9)	7,110,966	5,240,140	3,692,000
Income before cumulative effect of accounting change	9,927,402	7,526,227	4,974,171
Cumulative effect of accounting change (note 1)	(1,655,702)	—	—
Net income	8,271,700	7,526,227	4,974,171
Accretion on put warrants (note 10)	—	(360,050)	(212,000)
Net income available to common stockholders	$ 8,271,700	7,166,177	4,762,171

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)
Consolidated Statement of Stockholders' Equity and Comprehensive Income
Year ended April 30, 2006

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Preferred stock, Class B		Special voting preferred stock	
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**
Balance at May 1, 2005	5,500,853	$ 5,500,853	450,000	$ 450,000	190,000	$ 2,375,000	25,000	$ 497,742	10	$ 10
Issuance of common stock in connection with purchase of customer lists	2,000	2,000	—	—	—	—	—	—	—	—
Exercise of warrants (note 10)	121,320	121,320	—	—	—	—	—	—	—	—
Exercise of stock options (note 11)	155,090	155,090	—	—	—	—	—	—	—	—
Balance at April 30, 2006	5,779,263	$ 5,779,263	450,000	$ 450,000	190,000	$ 2,375,000	$ 25,000	$ 497,742	10	$ 10

	Exchangeable shares		Common stock committed to be issued		Put warrants	Additional paid-in capital	Treasury stock		Accumulated other comprehensive income	Retained earnings	Total
	Shares	**Amount**	**Shares**	**Amount**			**Shares**	**Amount**			
Balance at May 1, 2005	100,000	$ 100,000	4,000	$ 32,000	1,679,578	9,595,083	323,000	$ (1,288,000)	205,144	13,723,749	32,871,159
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	—	—	(2,000)	(16,000)	—	78,342	—	—	—	—	64,342
Adoption of FASB statement No. 150 (note 10)	—	—	—	—	(1,679,578)	1,679,578	—	—	—	—	—
Exercise of warrants (note 10)	—	—	—	—	—	181,980	—	—	—	—	303,300
Exercise of stock options, including income tax benefit of $469,420 (note 11)	—	—	—	—	—	926,798	—	—	—	—	1,081,888
Repurchase of outstanding stock	—	—	—	—	—	—	17,500	(140,000)	—	—	(140,000)
Net income	—	—	—	—	—	—	—	—	—	8,271,700	8,271,700
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	133,680	—	133,680
Comprehensive income											8,405,380
Balance at April 30, 2006	100,000	$ 100,000	2,000	$ 16,000	—	12,461,781	340,500	$ (1,428,000)	338,824	21,995,449	42,586,069

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)
Consolidated Statement of Stockholders' Equity and Comprehensive Income
Year ended April 30, 2005

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Preferred stock, Class B		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2004	5,278,477	$ 5,278,477	450,000	$ 450,000	190,000	$ 2,375,000	25,000	$ 497,742	10	$ 10
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	15,381	15,381	—	—	—	—	—	—	—	—
Exercise of stock options (note 11)	206,995	206,995	—	—	—	—	—	—	—	—
Balance at April 30, 2005	5,500,853	$ 5,500,853	450,000	$ 450,000	190,000	$ 2,375,000	25,000	$ 497,742	10	$ 10

	Exchangeable shares		Common stock committed to be issued		Put warrants	Additional paid-in capital	Treasury stock		Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount	Shares	Amount			Shares	Amount			
Balance at May 1, 2004	100,000	$ 100,000	6,000	$ 48,000	1,319,528	8,635,581	270,000	$ (864,000)	136,968	6,557,572	24,534,878
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	—	—	(2,000)	(16,000)	—	224,019	—	—	—	—	223,400
Accretion of put warrants (note 10)	—	—	—	—	360,050	—	—	—	—	(360,050)	—
Exercise of stock options (note 11)	—	—	—	—	—	735,483	—	—	—	—	942,478
Repurchase of outstanding stock	—	—	—	—	—	—	53,000	(424,000)	—	—	(424,000)
Net income	—	—	—	—	—	—	—	—	—	7,526,227	7,526,227
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	68,176	—	68,176
Comprehensive income											7,594,403
Balance at April 30, 2005	100,000	$ 100,000	4,000	$ 32,000	1,679,578	9,595,083	323,000	$ (1,288,000)	205,144	13,723,749	32,871,159

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)
Consolidated Statement of Stockholders' Equity and Comprehensive Income
Year ended April 30, 2004

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Preferred stock, Class B		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2003	4,988,770	$ 4,988,770	450,000	$ 450,000	190,000	$ 2,375,000	25,000	$ 497,742	10	$ 10
Common stock issued, net of issuance costs of $1,141	37,190	37,190	—	—	—	—	—	—	—	—
Issuance of common stock in connection with services rendered	1,819	1,819	—	—	—	—	—	—	—	—
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	152,223	152,223	—	—	—	—	—	—	—	—
Exercise of warrants (note 10)	8,975	8,975	—	—	—	—	—	—	—	—
Exercise of stock options (note 11)	89,500	89,500	—	—	—	—	—	—	—	—
Balance at April 30, 2004	5,278,477	$ 5,278,477	450,000	$ 450,000	190,000	$ 2,375,000	25,000	$ 497,742	10	$ 10

	Exchangeable shares		Common stock committed to be issued		Put warrants	Additional paid-in capital	Treasury stock		Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount	Shares	Amount			Shares	Amount			
Balance at May 1, 2003	100,000	$ 100,000	8,000	$ 64,000	1,107,528	7,044,173	257,500	$ (826,500)	78,077	1,795,401	17,674,201
Common stock issued, net of issuance costs of $1,141	—	—	—	—	—	259,189	—	—	—	—	296,379
Issuance of common stock in connection with services rendered	—	—	—	—	—	18,190	—	—	—	—	20,009
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	—	—	(2,000)	(16,000)	—	1,061,116	—	—	—	—	1,197,339
Accretion of put warrants (note 10)	—	—	—	—	212,000		—	—	—	(212,000)	—
Exercise of stock options (note 11)	—	—	—	—	—	150,500	—	—	—	—	240,000
Exercise of warrants (note 10)	—	—	—	—	—	13,463	—	—	—	—	22,438
Modification of exercise period for options (note 11)	—	—	—	—	—	88,950	—	—	—	—	88,950
Repurchase of outstanding stock	—	—	—	—	—	—	12,500	(37,500)	—	—	(37,500)
Net income	—	—	—	—	—	—	—	—	—	4,974,171	4,974,171
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	58,891	—	58,891
Comprehensive income											5,033,062
Balance at April 30, 2004	100,000	$ 100,000	6,000	$ 48,000	1,319,528	8,635,581	270,000	$ (864,000)	136,968	6,557,572	24,534,878

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statements of Cash Flows

Years ended April 30, 2006, 2005 and 2004

	2006	2005	2004
Cash flows from operating activities:			
Net income	$ 8,271,700	7,526,227	4,974,171
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change	1,655,702	—	—
Depreciation and amortization	1,868,950	1,236,990	974,975
Write-down of impaired assets	344,356	327,937	583,078
Amortization of deferred financing costs and original issue discount	207,156	502,109	219,577
Compensation expense for modification of exercise period for options	—	—	88,950
Compensation expense for stock issued in connection with services rendered	—	—	20,009
Tax benefit of stock option exercises	469,420	—	—
Provision for doubtful accounts and franchise fee refunds	5,478,444	4,022,416	4,765,976
Gain on sale of intangible assets and property and equipment, net	(106,723)	(227,941)	(146,947)
Gain on early extinguishment of long-term debt	—	—	(22,583)
Accrued interest on subordinated debt	626,958	226,121	—
Deferred tax expense (benefit)	(617,950)	37,143	(203,000)
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:			
Trade accounts receivable	(12,177,515)	(7,638,985)	(5,821,802)
Notes receivable	(8,518,191)	(8,613,297)	(9,355,091)
Refund anticipation loan fees	(298,542)	1,553,712	(3,253,883)
Interest receivable	(548,878)	(1,573,784)	(717,883)
Inventory	614,418	(849,950)	(163,866)
Prepaid expenses and other current assets	940,128	(825,559)	(532,211)
Other assets	(17,968)	68,536	(11,689)
Accounts payable and accrued expenses	6,951,236	(338,477)	4,024,347
Income taxes payable	3,408,740	3,848,867	3,858,714
Deferred franchise fees and franchise deposits	3,609,725	1,822,470	2,160,949
Other long-term liabilities	—	—	5,026
Net cash provided by operating activities	12,161,166	1,104,535	1,446,817
Cash flows from investing activities:			
Issuance of operating loans to franchisees	(8,411,883)	(7,341,161)	(6,029,926)
Payments received on operating loans from franchisees	6,530,657	5,602,533	3,819,809
Purchases of customer lists and other assets	(748,532)	(797,216)	(491,446)
Payments issued in conjunction with exchanges of territories	(193,470)		
Proceeds from sale of customer lists and other assets	293,770	298,005	286,737
Proceeds from sale of short-term investments	3,214	4,734	105,014
Purchases of long-term investments	(40,000)	—	—
Purchases of property and equipment	(2,491,214)	(1,592,988)	(932,376)
Increase in cash from consolidation of VIEs	174,044	—	—
Net cash used in investing activities	(4,883,414)	(3,826,093)	(3,242,188)
Cash flows from financing activities:			
Proceeds from sales of common stock, net of issuance costs	—	—	296,379
Proceeds from the exercise of stock options and warrants	915,768	942,478	262,438
Proceeds from issuance of long-term debt	—	13,000,000	—
Payment for debt issuance costs	—	(1,036,358)	—
Purchase of treasury stock	(140,000)	(424,000)	(37,500)
Net borrowings (repayments) under lines of credit	—	(1,039,800)	1,988,405
Repayment of obligations under capital lease	(85,443)	(82,527)	(72,834)
Repayment of long-term debt	(985,247)	(1,494,057)	(1,228,422)
Net cash provided by (used in) financing activities	(294,922)	9,865,736	1,208,466
Effect of exchange rate changes on cash	(595,630)	(367,224)	(162,235)
Net increase (decrease) in cash and cash equivalents	6,387,200	6,776,954	(749,140)
Cash and cash equivalents at beginning of year	7,035,148	258,194	1,007,334
Cash and cash equivalents at end of year	$ 13,422,348	7,035,148	258,194

(Continued)

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statements of Cash Flows

Years ended April 30, 2006, 2005 and 2004

		2006	2005	2004
Supplemental disclosure of cash flow information -				
Cash paid for interest	$	2,457,976	1,446,225	579,277
Supplemental disclosure of noncash investing and financing activities:				
During the years ended April 30, 2006, 2005 and 2004, the Company acquired certain assets from franchisees as follows:				
Fair value of assets purchased	$	4,352,207	4,454,268	4,175,723
Receivables forgiven		(6,275,704)	(3,775,863)	(1,700,510)
Accounts payable cancelled		276,924	125,461	—
Liabilities assumed		(196,573)	(163,357)	—
Notes payable issued		(246,049)	(191,164)	(776,015)
Deferred revenue recognized		2,670,086	788,295	37,330
Common stock issued		—	(171,432)	(1,157,332)
Applied from (to) sales of franchise territories		167,641	(268,992)	(87,750)
Cash paid to seller	$	748,532	797,216	491,446
During the year ended April 30, 2006, 2005 and 2004, the Company sold certain assets to franchisees as follows:				
Book value of assets sold	$	2,882,993	3,477,703	2,367,374
Gain on sale		105,770	231,942	146,933
Deferred gain on sale		217,476	733,499	376,420
Applied from acquisitions of franchise territories		—	(249,206)	(87,750)
Notes issued		(2,912,469)	(3,895,933)	(2,516,240)
Cash received	$	293,770	298,005	286,737

In 2006, certain franchisees exchanged their existing territories for others. In conjunction with these transactions, the Company recorded intangible assets of $493,053, receivables of $1,364,739, recorded deferred revenue of $578,672 and recognized franchise fees of $1,085,650. Cash of $193,470 was paid by the Company in conjunction with these exchanges.

In 2005, $2,000,000 of subordinated debt issued in 2001 was refinanced under a new subordinated debt agreement (note 8).

In 2004, the Company entered into capital lease arrangements for the purchase of property and equipment with costs of $213,943.

In 2004, the Company converted a $2,000,000 operating line of credit to a term note.

In 2004, the Company refunded franchise fees of $40,007 through the issuance of common stock.

See accompanying notes to consolidated financial statements.

(1) Organization and Significant Accounting Policies

(a) Organization

JTH Tax, Inc. and subsidiaries (d/b/a Liberty Tax Service) (the Company) is a franchisor and operator of a system of offices in the United States and Canada engaged in the preparation of personal income tax returns. Through this system of offices, the Company also facilitates to its customers refund based financial products such as refund anticipation loans, electronic refund checks and personal income tax refund discounting. The Company operates under the trade name "Liberty Tax Service."

The Company was formed in October 1996 as a Delaware corporation. EmployeesPlus, Inc., a Virginia corporation and a wholly owned subsidiary of the Company, was created in November 2000 and currently operates Company-owned store locations. Liberty Tax Service, Inc., (the Canadian Subsidiary) was incorporated under the Companies Act of Manitoba, Canada in May 1994 and was 60% owned by JTH Tax, Inc. until October 2001. Liberty Tax Holding Corporation (Holdings) was created in October 2001 as an Ontario Corporation and is a wholly owned subsidiary of JTH Tax, Inc. Holdings acquired the remaining 40% ownership of the Canadian Subsidiary effective October 31, 2001. WeFile, Inc., a wholly owned subsidiary, was created in 2002 as a Virginia corporation to hold Internal Revenue Service Electronic Filing Numbers.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of JTH Tax, Inc. and its wholly owned subsidiaries, EmployeesPlus, Inc., Liberty Tax Service, Inc., Liberty Tax Holding Corporation and WeFile, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

Assets and liabilities of the Canadian Subsidiary have been translated into U.S. Dollars using the exchange rate in effect at the end of the year. The revenues and expenses have been translated using the average exchange rates in effect each month of the year. Transaction gains and losses are recognized in income when incurred.

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46). In December 2003, the FASB issued a revision to FIN 46 to make certain technical corrections and address certain implementation issues that had arisen (FIN 46R). The Company adopted FIN 46R as of December 31, 2003. FIN 46R requires the consolidation of a variable interest entity (VIE) if the Company is deemed to be the primary beneficiary of the VIE. FIN 46R requires an entity to assess its equity investments and certain other contractual interests to determine if they are variable interest entities. As defined in FIN 46R, variable interests are contractual, ownership or other interests in an entity that change with changes in the entity's net asset value. Variable interests in an entity may arise from financial instruments, service contracts, guarantees, leases or other arrangements with the variable interest entity. The Company may, in certain cases, provide financing or guarantee financing to unit franchisees or area developers. The Company does not possess any ownership interest in any franchise or area developer entities nor does it typically provide ongoing financial support to these entities. Unit franchisees or area developers generally qualify as VIEs due to the existence of financing provided to purchase the franchise and/or for working capital and equipment needs.

An entity that will absorb a majority of the VIE's expected losses or expected residual returns, as defined in FIN 46R, is considered the primary beneficiary of the VIE. The primary beneficiary should include the VIE's assets, liabilities and results of operations in its consolidated financial statements. During 2006, the Company was deemed to be the primary beneficiary of 16 of its franchise entities due to the relatively significant financial support provided to these entities. The Company does not hold an ownership interest in any of these entities. The summarized effect of these entities in the consolidated balance sheet at April 30, 2006, and the consolidated statement of income for the year then ended, is as follows:

		JTH Tax, Inc. and subsidiaries	VIEs	Consolidating adjustments and eliminations	Consolidated
Assets					
Current assets	$	64,703,149	343,513	(2,711,879)	62,334,783
Non-current assets		37,069,590	1,577,970	(1,278,127)	37,369,433
Total assets	$	101,772,739	1,921,483	(3,990,006)	99,704,216
Liabilities, Minority Interest and Stockholders' Equity					
Current liabilities	$	38,124,875	3,258,759	(3,008,486)	38,375,148
Non-current liabilities		18,722,547	1,140,140	(1,140,140)	18,722,547
Total liabilities		56,847,422	4,398,899	(4,148,626)	57,097,695
Minority interest		—	—	20,452	20,452
Stockholders' equity (deficit)		44,925,317	(2,477,416)	138,168	42,586,069
Total liabilities, minority interest and stockholders' equity	$	101,772,739	1,921,483	(3,990,006)	99,704,216
Revenue	$	64,281,546	2,773,060	(902,060)	66,152,546
Operating expenses		46,101,962	3,844,685	(1,237,210)	48,709,437
Other, net		(457,670)	—	52,929	(404,741)
Income (loss) before income taxes and cumulative effect of accounting change		17,721,914	(1,071,625)	388,079	17,038,368
Income tax expense		7,110,966	—	—	7,110,966
Income (loss) before cumulative effect of accounting change		10,610,948	(1,071,625)	388,079	9,927,402
Cumulative effect of accounting change		—	—	(1,655,702)	(1,655,702)
Net income (loss)	$	10,610,948	(1,071,625)	(1,267,623)	8,271,700

(Continued)

(c) ***Cash and Cash Equivalents***

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

(d) ***Restricted Cash***

Restricted cash includes amounts held in an escrow account as collateral for the Company's guarantee of certain borrowings of its franchisees (note 14).

(e) ***Short-Term Investments***

Short-term investments consist of a bond mutual fund. This investment is stated at fair value with any unrealized holding gains or losses included in earnings.

(f) ***Trade Accounts Receivable***

Trade accounts receivable are recorded at the invoiced amount and bear interest at 18% annually once they have aged greater than 30 days. Finance charges are fully reserved and are only recognized in income when they have been paid. The allowance for doubtful accounts includes the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. Because the repayment of accounts receivable is dependent on the performance of the underlying franchisees, management estimates the amount of the allowance for doubtful accounts based on a comparison of amounts due to the estimated fair value of the underlying franchise. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its accounts receivable.

(g) ***Notes Receivable***

Notes receivable are recorded at cost, less the related allowance for doubtful accounts. Because the repayment of the notes receivable is dependent on the performance of the underlying franchise which collateralizes the note, management estimates the amount of the allowance for doubtful accounts based on a comparison of amounts due to the estimated fair value of the underlying franchise. The Company provides an allowance against accrued interest on a delinquent note when a scheduled payment becomes 90 days past due or the recorded value of the note receivable exceeds the value of the underlying franchise. Loans are written off against the allowance when all possible means of collection have been exhausted and the potential for recovery is considered remote.

(h) ***Inventory***

Inventory consists of supplies and signs for sale to franchisees. Inventories are stated at the lower of cost or market, determined on a first-in, first-out basis (FIFO).

(i) ***Property, Equipment and Software***

Property, equipment and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is calculated using the straight-line method over the estimated useful lives of the depreciable assets, generally three to five years for computer equipment, three years for software, seven years for furniture and fixtures and 20 to 35 years for buildings. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful lives of the assets.

(j) Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill is not amortized, but instead tested for impairment at least annually in accordance with the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets*. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

(k) Other Assets

Other assets consist of deferred financing costs which are being amortized over the term of the related financing using the effective interest method and deposits related to leased space and utilities.

(l) Deferred Franchise Fees

The Company may receive all or part of the initial franchise fee prior to the execution of the franchise agreement or completion of the earnings process. These amounts are classified as deferred franchise fees until the franchise fee qualifies to be recognized as revenue or is refunded.

(m) Franchise Deposits

For the period from May 1, 1999 through November 1, 1999, the Company waived the initial franchise fee for new franchise territories except in areas of the United States where the Company had operated prior to May 1, 1999 and in Hampton Roads, Virginia. The Company required that these new franchisees pay a security deposit for each territory. These security deposits are held by the Company until expiration or termination of the franchise agreement.

(n) Treasury Stock

Treasury stock is accounted for under the cost method.

(o) Revenue Recognition

Franchise fee revenue, net of a provision for franchise fee refunds, is recognized when obligations of the Company to prepare the franchisee for operation have been substantially completed. Franchise fees are also recognized from area developer sales wherein the Company sells a cluster of territories to an individual. Franchise fees that are financed by the Company are recorded as deferred franchise fees until such time as the unit franchisee or area developer has made a significant financial commitment (20% of the franchise fee).

Royalties and advertising fees are recognized currently as the franchised territory generates sales. Tax return preparation fees, bank product and tax discounting fees are recognized as revenue in the period the related tax return is filed or prepared for the customer. Discounts for promotional programs are recorded at the time the return is prepared.

Gains on sales of Company-owned stores, which are financed by the Company, are deferred until the franchisee has made a significant financial commitment (20%). Losses on sales of Company-owned stores are recognized immediately.

(p) ***Other, net***

Other, net consists of a net loss incurred on the settlement of various litigation totaling $457,670 for the year ended April 30, 2006, a net gain incurred on the settlement of various litigation totaling $288,229 for the year ended April 30, 2005 and a net gain on the early extinguishment of long-term debt and the settlement of various litigation of $25,996 for the year ended April 30, 2004.

(q) ***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(r) ***Impairment of Long-Lived Assets***

In accordance with Statement 144, long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill is tested annually for impairment, and is tested for impairment more frequently if events and circumstance indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a

(Continued)

purchase price allocation, in accordance with FASB Statement No. 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

For the years ended April 30, 2006, 2005 and 2004, the Company recognized an impairment loss of $344,356, $327,937 and $583,078, respectively, related to Company-owned stores which has been included in depreciation, amortization and impairment charges in the accompanying consolidated statements of income.

(s) Comprehensive Income

Comprehensive income consists of net income and the foreign currency translation adjustment and is presented in the accompanying consolidated statements of stockholders' equity.

(t) Stock-Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations in accounting for its fixed stock option plan. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. FASB Statement No. 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by Statement 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure only requirements of Statement 123.

If the accounting provisions of Statement 123 had been adopted, the Company's net income available to common shareholders would have been reduced to the pro forma amounts indicated in the following table:

		2006	2005	2004
Net income available to common stockholders - as reported	$	8,271,700	7,166,177	4,762,171
Deduct: Total stock-based employee compensation expense determined under fair value-based method, net of related tax effects		1,037,305	510,936	156,195
Net income available to common stockholders under Statement 123	$	7,234,395	6,655,241	4,605,976

These pro forma amounts for Statement 123 may not be representative of future disclosures because compensation cost is reflected over the options' vesting periods and because additional options may be granted in future years.

(Continued)

(u) ***Use of Estimates***

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

(v) ***Reclassification***

Certain 2005 and 2004 amounts have been reclassified to conform to the 2006 financial statement presentation.

(2) Notes and Accounts Receivable

The Company provides financing to franchisees for the purchase of franchises and/or for working capital and equipment needs. The notes generally are payable annually over five years and bear interest at various rates ranging from 8% to 12.0%. Transactions for 2006 and 2005 are as follows:

		2006	2005
Balance at beginning of year	$	41,091,153	28,713,718
Impact of consolidating VIEs on beginning of year		(2,705,174)	—
Notes issued:			
Sales of franchise territories		20,988,667	15,251,322
Sales of Company-owned stores		2,662,469	3,895,933
Franchisee to franchisee note assumptions		2,212,515	938,689
Operating loans to franchisees		8,411,883	7,341,161
Refinancing of notes and accounts receivable		4,219,362	6,663,343
Repayment of notes		(19,082,541)	(12,525,716)
Notes canceled		(9,390,954)	(9,373,022)
Foreign currency adjustment related to notes		299,247	185,725
Balance at end of year	$	48,706,627	41,091,153

Notes receivable reflected on the accompanying consolidated balance sheets include notes related to the sale of Company-owned stores, as well as loans to franchisees for franchise fees, working capital and equipment. Most of the notes receivable reflected on the accompanying consolidated balance sheets are due from the Company's franchisees. The notes are collateralized by the underlying franchise and are guaranteed by the respective franchisee and franchise owner(s). The franchisees' ability to repay the notes is dependent upon the performance of the tax preparation industry as a whole and the Company in particular. Management believes that the recorded allowance is adequate based upon its consideration of the estimated value of the franchises supporting the receivables. Any adverse change in the tax preparation industry could affect the Company's estimate of the allowance.

At April 30, 2006 and 2005, the Company had an investment in impaired notes and related interest receivable of approximately $6,429,000 and $6,454,000, respectively, which had recorded values that exceeded the fair value of the underlying collateral by approximately $737,000 and $844,000, respectively. In addition, the Company had trade accounts receivable due from these franchisees of approximately $1,406,000 and $1,503,000 at April 30, 2006 and 2005, respectively. The Company has reflected an allowance of approximately $2,143,000 and $2,346,000, respectively, for this impairment in the accompanying consolidated balance sheets. Activity in the allowance for doubtful accounts for the years ended April 30, 2006 and 2005 is summarized as follows:

	2006	2005	2004
Beginning balance	$ 2,743,822	3,547,205	2,197,621
Impact of consolidating VIEs on beginning of year	(70,970)	—	—
Additions charged to expense	4,145,480	2,292,387	3,096,767
Provision for franchise fee refunds	1,333,004	1,730,029	1,669,209
Write-offs	(5,111,636)	(4,879,132)	(3,425,755)
Foreign currency adjustment related to allowance	43,721	53,333	9,363
Ending balance	$ 3,083,421	2,743,822	3,547,205

The Company's average investment in impaired notes receivable during the years ended April 30, 2006 and 2005 was approximately $6,456,000 and $5,973,000, respectively. Interest income related to impaired notes was approximately $746,000, $210,000 and $528,000 for the years ended April 30, 2006, 2005 and 2004, respectively. The Company's investment in notes receivable on nonaccrual status as of April 30, 2006 and 2005 was approximately $5,555,000 and $3,027,000, respectively.

(3) Property, Equipment and Software, Net

Property, equipment and software, net consists of the following at April 30, 2006 and 2005:

	2006	2005
Land	$ 330,229	188,049
Buildings	890,403	860,260
Leasehold improvements	820,582	511,094
Furniture, fixtures and equipment	3,145,376	2,288,274
Software	7,130,564	5,330,937
	12,317,154	9,178,614
Less accumulated depreciation and amortization	3,279,455	2,135,687
Property, equipment and software, net	$ 9,037,699	7,042,927

The software included above includes both internally developed software and purchased software. During 2002, the Company acquired a perpetual license for proprietary tax preparation software to be used by its Company-owned stores and franchisees. Capitalized costs related to this software totaled $5,753,323 and $4,350,938 at April 30, 2006 and 2005, respectively, and have been included in property, equipment and software in the accompanying consolidated balance sheets. This software was tested but was not in service as of April 30, 2006; thus amortization has not begun. The Company anticipates that it will be placed in service in the 2007 tax season.

(4) Other Intangible Assets

Other intangible assets, net consist of the following at April 30, 2006 and 2005:

	Amortization period	2006	2005
Customer lists	5 years	$ 4,404,587	2,074,146
Area franchise rights	10 years	874,312	312,645
		5,278,899	2,386,791
Less accumulated amortization		1,498,105	250,758
Intangible assets, net		$ 3,780,794	2,136,033

Amortization and impairment charges for the years ended April 30, 2006, 2005 and 2004 were $1,126,815, $730,508 and $984,943, respectively. Estimated amortization expense for the next five years is $841,881 in 2007, $726,033 in 2008, $667,859 in 2009, $604,747 in 2010, and $503,119 in 2011.

(5) Lines of Credit

The Company has a line of credit with a financial institution, which allows for borrowings up to $20,000,000 and accrues interest at LIBOR plus 1.85%. The line is collateralized by all the assets of the Company and expires on August 31, 2006. There were no borrowings against the line at April 30, 2006 and 2005. In July 2006, the line of credit was renegotiated with the bank to allow borrowings up to $25,000,000 at LIBOR plus 1.45% with an expiration date of July 31, 2008. The line of credit contains certain financial covenants, which the Company must meet, including a minimum debt service coverage ratio and a maximum debt to net worth ratio.

The Company has two lines of credit with a financial institution that it utilizes to fund the Canadian Subsidiary (one for discounting and one for a guidance facility). The discounting and guidance lines allow for borrowings up to $20,000,000 and $4,000,000 respectively and accrue interest at Canadian LIBOR plus 3%. There were no borrowings against either line at April 30, 2006 or 2005. Both lines expired May 31, 2006 and are collateralized by all the assets of the Company. In July 2006, the discounting line and the guidance facility were renegotiated with the bank to allow borrowings up to $20,000,000 and $5,000,000, respectively, with an expiration date of May 31, 2007. The lines contain certain financial covenants, which the Company must meet, including a minimum debt service coverage ratio and a maximum debt to net worth ratio.

(6) Leases

The Company is obligated under capital leases covering certain machinery and equipment that expire at various dates through 2008. The gross amount of property and equipment and related accumulated amortization thereon recorded under capital leases was $298,437 and $208,697 at April 30, 2006, respectively, and $298,437 and $135,003 at April 30, 2005, respectively, and is included in property and equipment, net in the accompanying consolidated balance sheets. Amortization of assets held under capital leases is included in depreciation, amortization and impairment charges in the accompanying consolidated statements of income.

The Company is also obligated under various operating leases for office space that expire at various dates (see note 15). Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of April 30, 2006 are:

	Capital leases	Operating leases
Year ending April 30:		
2007	$ 37,096	2,493,800
2008	13,421	1,821,271
2009	—	1,020,252
2010	—	570,241
2011	—	435,756
Thereafter	—	150,315
Total minimum lease payments	50,517	$ 6,491,635
Less amount representing interest (at 5%)	1,690	
Present value of net minimum capital lease payments	48,827	
Less current installments of obligations under capital leases	35,574	
Obligations under capital leases, excluding current installments	$ 13,253	

The Company has subleases under certain of these commitments as of April 30, 2006 amounting to $1,201,189 in 2007, $790,778 in 2008, $477,988 in 2009, $246,919 in 2010, $133,975 in 2011 and $23,748 thereafter.

Total rent expense for operating leases was approximately $1,707,000, $1,490,000 and $1,175,000 for the years ended April 30, 2006, 2005 and 2004, respectively.

(7) Long-Term Debt

Long-term debt at April 30, 2006 and 2005 consists of the following:

		2006	2005
Mortgage note payable to a bank in monthly installments of $1,236 including interest at 8.50% through December 2019; collateralized by land and building	$	117,450	122,076
Mortgage note payable to a bank in monthly installments of $1,389 including interest at 9.25% through August 2010; collateralized by land and building		102,138	109,014
Notes payable for acquired practices, interest rates ranging from 8% to 12%; due May 2005 through January 2011		731,614	891,291
Term note payable in four annual installments of $500,000 principal plus interest at LIBOR plus 2.5% beginning February 2005; collateralized by all assets of the Company		1,000,000	1,500,000
Total long-term debt		1,951,202	2,622,381
Less current installments		846,894	987,699
Total long-term debt, less current installments	$	1,104,308	1,634,682

Aggregate maturities of long-term debt as of April 30, 2006 are as follows:

2007	$	846,894
2008		752,076
2009		155,114
2010		26,721
2011		26,529
Thereafter		143,868
	$	1,951,202

The term note contains certain financial covenants, which the Company must meet, including a minimum debt service coverage ratio, a minimum level of tangible net worth and a maximum debt to net worth ratio.

(8) Subordinated Debt

In July 2001, the Company borrowed $2,000,000 from a venture capital group. In connection with securing the loan, the Company issued warrants to the lender to purchase 231,700 shares of Class A common stock at a nominal price (note 10). The value of the warrants issued was deemed to be $970,000 as of the date of issuance. The Company recorded original issue discount for this amount, which was reflected as a reduction of the outstanding subordinated debt balance of $2,000,000 as of April 30, 2004. The Company amortized the original issue discount over the life of the loan using the effective interest method. The loan was refinanced as a part of the subordinated loan described below. Because the refinancing constituted a

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debt extinguishment for accounting purposes, the remaining original issue discount and related loan costs were expensed in 2005 and reflected in the interest expense for 2005 and 2004 described below.

In November 2004, the Company entered an agreement to borrow $15,000,000 from a group of lenders, including the $2,000,000 refinanced above. The loan bears interest at 16%, with 12% payable quarterly and 4% added to the principal balance of the debt and payable at maturity. The compounded portion related to the 4% additional interest on the subordinated debt was $626,958 and $226,121 for the years ended April 30, 2006 and April 30, 2005, respectively, and was recorded as an increase to subordinated debt.

Deferred financing costs incurred in securing the loan are amortized over its life using the effective interest method. Interest expense totaling $207,156, $502,109 and $219,577 was recorded in 2006, 2005 and 2004, respectively, related to the amortization of deferred financing costs and the original issue discount.

Maturities of the debt are $1,500,000 in 2008, $4,000,000 in 2009; $6,000,000 in 2010; and $4,353,079 thereafter. The loan is collateralized by substantially all the assets of the Company, but is subordinated to the lines of credit discussed in note 5 and the $1,000,000 term note discussed in note 7. The loan contains certain financial covenants which the Company must meet, including minimum debt service coverage ratio and maximum total debt ratio.

(9) Income Taxes

Total income taxes were allocated as follows:

		2006	2005	2004
Income from continuing operations	$	7,110,966	5,240,140	3,692,000
Stockholders' equity, tax benefit on exercise of stock options		(469,420)	—	—
	$	6,641,546	5,240,140	3,692,000

Components of income tax expense for the years ended April 30, 2006, 2005 and 2004 were as follows:

		2006	2005	2004
Federal – current	$	6,292,958	4,183,210	3,134,000
Federal – deferred		(549,075)	29,863	(163,000)
State – current		1,497,767	1,019,787	761,000
State – deferred		(130,684)	7,280	(40,000)
	$	7,110,966	5,240,140	3,692,000

The Company's effective tax expense (computed by multiplying income before income taxes and cumulative effect of accounting change by the U.S. Federal statutory rate of 35% in 2006, 2005 and 2004) differs from tax expense for the years ended April 30, 2006, 2005, and 2004 as follows:

		2006	2005	2004
Computed "expected" income tax expense	$	5,963,429	4,468,228	3,033,000
Increase (decrease) in income taxes resulting from:				
State income taxes, net of federal benefit		888,604	667,594	469,000
Change in taxes resulting from permanent differences, net		75,600	106,097	127,000
Impact of consolidated nontaxable VIEs		356,544	—	—
Other		(173,211)	(1,779)	63,000
	$	7,110,966	5,240,140	3,692,000

The tax effect of temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to significant portions of deferred tax assets and liabilities at April 30, 2006 and 2005 are as follows:

		2006	2005
Deferred tax assets:			
Net operating loss carryforwards	$	287,923	476,510
Accounts payable and accrued liabilities, deductible for tax purposes when paid		276,405	271,404
Allowance for doubtful accounts, deductible for tax purposes when accounts are written off		2,747,006	2,343,778
Total deferred tax assets		3,311,334	3,091,692
Deferred tax liability:			
Section 481 adjustment associated with conversion from cash to accrual method of accounting		—	492,176
Property, equipment and software, due to differences in book and tax useful lives and depreciation and amortization methods		2,440,903	2,034,616
Prepaid expenses, deducted from taxable income when payment is made		272,815	647,043
Total deferred tax liabilities		2,713,718	3,173,835
Net deferred tax asset (liability)	$	597,616	(82,143)

In assessing the realizability of the gross deferred tax assets, management considers whether it is more likely than not that some portion of all the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in

(Continued)

which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

The Company has net operating loss carryforwards in Canada of approximately $720,000, of which approximately $106,000 expire in 2011; and $614,000 expire in 2012.

(10) Stockholders' Equity

(a) Preferred Stock and Exchangeable Shares

The Company has three authorized classes of preferred stock: Class A has 190,000 authorized shares, Class B has 33,334 authorized shares, and the special voting preferred stock has 10 authorized shares. All classes have a par value of $1.

The holders of the Class A preferred stock are entitled to a dividend if a dividend is declared for common stock and shall receive a dividend as if each share of preferred stock had been converted to Class A common stock in accordance with the conversion ratio, and a liquidation preference upon the liquidation, dissolution or consolidation of the Company. In the event of liquidation, dissolution or consolidation, the holders of Class A preferred stock will be entitled to receive out of the assets of the Company, after payment or provision for payment of the debts or other liabilities of the Company, the original issue price per share for each share of preferred stock then outstanding, plus an amount equal to the original issue price per share multiplied by 10% per annum from the original issue date, compounded annually to the date of such distribution. The liquidation value of the Class A preferred stock was $4,628,205 and $4,207,457 as of April 30, 2006 and 2005, respectively. Its carrying amount was $2,375,000 at April 30, 2006 and 2005.

A holder of the Class A preferred stock may, at the holder's option, elect to convert each share of the Class A preferred stock into five shares of fully paid and nonassessable shares of Class A common stock.

The holders of Class B preferred stock are entitled to the same rights and privileges as holders of Class A preferred stock except that in the event of liquidation, dissolution or consolidation, the holders of the Class B preferred stock are not entitled to a payment until the provision for payment to holders of Class A preferred stock has been satisfied. The liquidation value of the Class B preferred stock was $780,853 and $709,866 as of April 30, 2006 and 2005, respectively. Its carrying amount was $497,742 at April 30, 2006 and 2005, respectively.

In October 2001, the Company, through its wholly owned subsidiary, Holdings, acquired the remaining 40% of the outstanding common stock of the Canadian Subsidiary in a transaction which was accounted for as a purchase. Immediately preceding the acquisition, the Company issued 1,300,000 shares of common stock and 10 shares of special voting preferred stock to Holdings. In a single transaction, Holdings issued consideration to the minority shareholder consisting of 800,000 shares of Class A common stock and 10 shares of special voting preferred stock of the Company and

100,000 shares of exchangeable shares of Holdings in exchange for $2,000,000 in cash and the 40% minority interest in the Canadian subsidiary. The 100,000 exchangeable shares issued by Holdings are exchangeable at any time at a 5:1 ratio into the Class A common stock of the Company. The remaining 500,000 shares of Class A common stock of the Company issued to Holdings are held by Holdings to satisfy the exchange provisions of the exchangeable shares. These shares are eliminated in consolidation. The special voting preferred shares issued have a $1.00 par value and no liquidation value and entitle the holder to vote each share as if it represented 50,000 shares of Class A common stock. These shares will be cancelled as the holder exchanges the Holdings' exchangeable shares.

(b) Common Stock

The Company is authorized to issue 10,600,000 shares of Class A common stock, par value $1.00 per share and 500,000 shares of Class B common stock, par value $1.00 per share. Class A common stock and Class B common stock entitle the holders thereof to the same rights and privileges and are identical in all respects as to all matters, except the holders of Class B common stock are entitled to elect one more director than the number of directors elected by holders of the all other classes of stock combined. Also, a holder of Class B common stock may, at the holder's option, elect to convert the Class B common stock into an equal number of fully paid and nonassessable shares of Class A common stock.

During 2004, the Company sold 37,190 additional shares of Class A common stock at $8.00 for net proceeds of $296,379. Issuance costs in 2004 totaled $1,141.

During 2005 and 2004, in connection with the acquisition of franchises from existing franchisees, the Company issued a total of 13,381 and 150,223 shares of Class A common stock for $171,432 and $1,330,007, respectively. The Company did not issue shares of Class A common stock in the connection with the acquisition of franchises during 2006. In conjunction with a transaction that occurred in 2003, the Company agreed to issue 8,000 additional shares over the next five years at $8.00 per share. This obligation has been reflected in the accompanying consolidated balance sheets as shares committed to be issued.

(c) Warrants and put option

In July 2001, the Company issued 231,700 warrants to purchase Class A common stock to a venture capital group which loaned the Company $2,000,000 in subordinated debt (note 8). The warrants expire in July 2008 or the date of a qualified public offering, as defined. These warrants are exercisable immediately upon issuance at an exercise price of $0.00002 per share. The warrants were issued in conjunction with a freestanding put option which allows the holder, at its discretion, to put the warrants or underlying shares of stock obtained upon exercise back to the Company at a formula based on the Company's cash flow after the third anniversary date of the warrant agreement, which was July 30, 2004, or a nonqualified public offering, as defined. The put option expires in July 2011. The warrants and the put option were valued at $970,000 as of the date of issuance, and were accreted to the estimated redemption price over the period from issuance through July 30, 2004, and were carried at their estimated redemption price of $1,679,578 as of April 30, 2005. Accretion of $360,050 and $212,000 was recorded in 2005 and 2004, respectively.

Effective May 1, 2005, the Company adopted FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The put option associated with these warrants is within the scope of this Statement. The fair value of the put option has been estimated at $50,000 and as a result, adoption of FAS 150 was immaterial to the consolidated financial statements.

Changes in the fair value of the Company's common stock do not affect the redemption price of the put option. If settlement of the put option were to occur at April 30, 2006, the amount that would be paid under the formula specified in the agreement is $2,412,863. The agreement does not limit the amount the Company would be required to pay.

(d) Other Warrants

The Company issued 130,295 warrants to officers and directors in June 2001 in conjunction with short-term loans to the Company totaling $1,302,967. All of the loans were repaid in fiscal year 2002. All of these warrants had been exercised as of April 30, 2006.

(11) Stock Compensation Plan

In May 1998, the board of directors approved the JTH Tax, Inc. Stock Option Plan (the Plan). Employees and outside directors are eligible to receive awards under the Plan and 2,000,000 shares of Class A common stock have been authorized for grant under the Plan. At April 30, 2006, approximately 277,000 shares of Class A common stock are available for grant under the Plan.

The Company applies APB Opinion No. 25 and related interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized for fixed stock options, which were granted with an exercise price equal to the stock's estimated fair market value at the date of grant. However, in 2004, the Company modified a grant made to a terminating employee to extend the expiration date on vested shares. Compensation expense associated with the modification of $88,950 was recorded in the 2004 statement of income.

The weighted average fair value of option grants in 2006 was $3.40 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 0%, risk-free interest rates of 3.83% – 5.12% and expected life of five years. The weighted average fair value of option grants in 2005 was $2.30 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 0%, risk-free interest rates of 3.61% – 3.96% and expected life of five years. The weighted average fair value of option grants in 2004 was $1.10 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 0%, risk-free interest rate of 2.27% –3.07% and expected life of five years.

Stock option activity during the periods indicated is as follows:

	Number of options	Weighted average exercise price
Outstanding at April 30, 2003	782,710	$ 4.31
Granted	282,700	9.12
Exercised	(89,500)	2.68
Expired	—	—
Forfeited	(94,950)	7.89
Outstanding at April 30, 2004	880,960	5.63
Granted	369,900	13.42
Exercised	(206,995)	4.55
Expired	—	—
Forfeited	(53,725)	4.96
Outstanding at April 30, 2005	990,140	8.78
Granted	349,850	17.48
Exercised	(155,090)	3.95
Expired	—	—
Forfeited	(15,850)	14.56
Outstanding at April 30, 2006	1,169,050	11.95

At April 30, 2006, 2005 and 2004 the number of options exercisable was 1,015,717, 803,474 and 800,960, respectively, and the weighted average exercise price of those options was $11.62, $7.73 and $5.10, respectively.

The following tables summarize information about stock options outstanding and exercisable at April 30, 2006:

Number of shares outstanding at April 30, 2006	Range of exercise prices	Weighted average exercise price	Weighted average remaining contractual life	Number of shares exercisable at April 30, 2006	Weighted average exercise price
59,750	$ 2.50	2.50	31 days	59,750	$ 2.50
167,300	2.00 - 5.50	4.84	1 year	167,300	4.84
148,900	8.00 - 8.80	8.11	2 years	148,900	8.11
314,100	11.00 - 13.75	12.12	3 years	264,100	12.28
328,650	14.00 - 18.70	16.05	4 years	225,317	16.33
150,350	18.00 - 19.80	18.06	5 years	150,350	18.06

(Continued)

(12) Related Party Transactions

The following summarizes the Company's related party transactions:

Purchases and Sales of Franchises and Customer Lists and Other Assets – During 2006, 2005 and 2004, franchises were sold to related parties for $1,550,430, $105,000 and $1,554,650, respectively. In 2006, payment for these sales consisted of cash of $227,130 and notes receivable of $1,323,300. In 2005, payment for these sales consisted of cash of $105,000. In 2004, the Company received cash of $80,318 and notes receivable of $1,474,332 for the franchise sales to related parties. Of the total sales price in 2004, $763,791 was reflected as deferred franchise fees at April 30, 2004 because the franchisee had not yet made a significant financial commitment (20%). In 2005, these deferred franchise fees of $763,791 were recognized as income.

Under area franchise arrangements held by related parties, $415,481, $627,092 and $405,430 was paid to related parties in 2006, 2005 and 2004, respectively, for franchise fees and royalties collected by the Company on their behalf. As of April 30, 2006 and April 30, 2005, $240,498 and $173,663, respectively, was recorded as a liability to related area franchisees, and is reflected as a component of accounts payable and accrued expenses in the accompanying consolidated balance sheets.

Notes Receivable – At April 30, 2006 and 2005, related parties owed the Company $1,879,472 and $1,113,591, respectively, under notes receivable. Repayments of notes receivable from these parties during 2006 and 2005 were $393,380 and $632,558, respectively. Notes receivable from related parties relate to sales of franchise territories and are subject to the same terms and conditions as notes with unrelated parties, which are described in note 2.

Other – During 2006 and 2005, the Company assisted in the sale of 25,670 and 20,700 shares of common stock for related parties, respectively. Proceeds to related parties under these sales were $455,272 in 2006 and $316,900 in 2005.

(13) Employee Benefit Plan

The Company has a 401(k) profit sharing plan covering substantially all employees, which allows for voluntary contributions. The Company does not currently make contributions to the plan.

(14) Commitments and Contingencies

The Company has guaranteed borrowings of certain franchisees with two third-parties that provide financing to franchisees for operations. Under the arrangements, the Company would be required to perform in the event of nonpayment by the franchisees to the third parties. Total guaranteed borrowings were $1,200,707 as of April 30, 2006. Pursuant to the requirements of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, the Company recorded a liability of $74,227 related to its stand ready obligation under the guaranty arrangements at both April 30, 2006 and 2005, which is included in other long-term liabilities in the accompanying consolidated balance sheets. In addition, the Company recorded a liability of $445,420 and $468,742 as of April 30, 2006 and 2005, respectively, included in accounts payable and accrued expenses in the accompanying consolidated balance sheets, related to borrowings for which performance by the Company under the guarantees is probable.

The Company is a defendant in certain lawsuits and is aware of other threatened claims generally incidental to its business as a franchisor. Management is of the opinion that the accompanying consolidated financial statements will not be materially affected by the ultimate resolution of litigation pending or threatened as of April 30, 2006.

(15) Subsequent Event

In June 2006, the Company issued a letter of intent to exercise its option to purchase the building housing its corporate headquarters in Virginia for approximately $2,650,000. The Company has leased the facility since July 2004. Future minimum lease payments under the current lease are $269,216 in 2007, $277,288 in 2008, $285,610 in 2009, $294,184 in 2010, $303,010 in 2011 and $50,748 thereafter and are included in operating leases disclosed in note 6. Lease payments will cease subsequent to closing the purchase transaction.