



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

Consolidated Financial Statements

April 30, 2008, 2007 and 2006

(With Independent Auditors' Report Thereon)



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. and subsidiaries (d/b/a Liberty Tax Service) (the Company) as of April 30, 2008 and 2007, 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, 2008. 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, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended April 30, 2008, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

June 24, 2008

JTH TAX, INC. AND SUBSIDIARIES

(d/b/a Liberty Tax Service)

Consolidated Balance Sheets

April 30, 2008 and 2007

(In thousands)

Assets (Notes 6 and 7)	2008	2007
Current assets:		
Cash and cash equivalents	\$ 2,930	20,914
Short-term investments	9,370	—
Receivables (note 2):		
Trade accounts	23,629	18,916
Notes	23,780	27,351
Refund anticipation loan fees, net	4,333	4,540
Interest	2,507	2,211
Allowance for uncollectible amounts	(3,474)	(3,228)
Total receivables, net	<u>50,775</u>	<u>49,790</u>
Prepaid expenses and other current assets	642	450
Deferred income taxes (note 9)	1,753	2,622
Total current assets	<u>65,470</u>	<u>73,776</u>
Property, equipment and software, net (note 3)	18,521	20,417
Notes receivable, excluding current portion, net of allowance for uncollectible amounts of \$2,391 and \$1,949 for 2008 and 2007, respectively (note 2)	34,327	26,504
Goodwill	1,913	1,913
Other intangible assets, net (note 4)	5,948	3,430
Other assets, net	1,359	425
Total assets	<u>\$ 127,538</u>	<u>126,465</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Current installments of long-term debt (note 7)	\$ 1,922	6,014
Accounts payable and accrued expenses (note 14)	23,473	20,452
Income taxes payable (note 9)	10,005	6,794
Deferred franchise fees	12,611	8,046
Total current liabilities	<u>48,011</u>	<u>41,306</u>
Long-term debt, excluding current installments (note 7)	4,386	16,580
Line of credit (note 6)	9,838	—
Deferred income taxes (note 9)	10,605	10,857
Total liabilities	<u>72,840</u>	<u>68,743</u>
Stockholders' equity (notes 10, 11 and 16):		
Preferred stock	2,375	2,873
Special voting preferred stock	—	—
Common stock	13,479	13,101
Exchangeable shares	100	100
Additional paid-in capital	4,675	6,508
Treasury stock, at cost	(20,880)	(2,959)
Accumulated other comprehensive income, net	358	374
Retained earnings	54,591	37,725
Total stockholders' equity	<u>54,698</u>	<u>57,722</u>
Commitments, contingencies and subsequent events (notes 2, 5, 6, 14 and 16)		
Total liabilities and stockholders' equity	<u>\$ 127,538</u>	<u>126,465</u>

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, 2008, 2007 and 2006

(In thousands)

	2008	2007	2006
Revenues (note 15):			
Franchise fees, net of provision for franchise fee refunds of \$1,821 in 2008, \$1,874 in 2007 and \$1,330 in 2006	\$ 21,393	22,319	23,561
Royalties and advertising fees	26,341	20,798	16,761
Bank product and tax discounting income	22,546	17,992	14,919
Interest income (note 2)	7,511	6,437	4,861
Tax preparation fees, net of discounts	4,481	5,045	4,829
Gain on sale of intangibles and property and equipment, net	841	196	107
Other revenue	4,520	2,361	1,114
Total revenues	87,633	75,148	66,152
Operating expenses (note 15):			
Employee compensation and benefits	20,180	17,801	14,823
General and administrative expenses	22,459	20,944	20,586
Advertising expense	10,133	8,644	8,019
Interest expense (notes 6 and 7)	2,002	2,729	3,068
Loss on extinguishment of debt (note 8)	—	886	—
Depreciation, amortization and impairment charges (notes 3 and 4)	4,975	3,163	2,213
Total operating expenses	59,749	54,167	48,709
Other, net (note 15)	96	18	(405)
Gain on deconsolidation of variable interest entities (note 15)	—	3,055	—
Income before income taxes and cumulative effect of accounting change	27,980	24,054	17,038
Income tax expense (note 9)	11,114	8,324	7,111
Income before cumulative effect of accounting change	16,866	15,730	9,927
Cumulative effect of accounting change (note 15)	—	—	(1,656)
Net income (note 15)	\$ 16,866	15,730	8,271

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, 2008

(In thousands)

	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, 2007	12,201	\$ 12,201	900	\$ 900	190	\$ 2,375	25	\$ 498	—	\$ —
Issuance of common stock in connection with purchase of customer lists	4	4	—	—	—	—	—	—	—	—
Exercise of stock options (note 11)	374	374	—	—	—	—	—	—	—	—
Repurchase of outstanding stock	—	—	—	—	—	—	(25)	(498)	—	—
Balance at April 30, 2008	<u>12,579</u>	<u>\$ 12,579</u>	<u>900</u>	<u>\$ 900</u>	<u>190</u>	<u>\$ 2,375</u>	<u>—</u>	<u>\$ —</u>	<u>—</u>	<u>\$ —</u>

	Exchangeable shares		Additional paid-in capital	Treasury stock		Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount		Shares	Amount			
Balance at May 1, 2007	100	\$ 100	6,508	840	\$ (2,959)	374	37,725	57,722
Issuance of common stock in connection with purchase of customer lists	—	—	52	—	—	—	—	56
Exercise of stock options (note 11)	—	—	945	—	—	—	—	1,319
Stock-based compensation expense (note 11)	—	—	869	—	—	—	—	869
Stock option income tax benefit (note 9)	—	—	541	—	—	—	—	541
Repurchase of outstanding stock and stock options	—	—	(4,240)	1,117	(17,921)	—	—	(22,659)
Net income	—	—	—	—	—	—	16,866	16,866
Foreign currency translation adjustment, net	—	—	—	—	—	(16)	—	(16)
Comprehensive income	—	—	—	—	—	—	—	16,850
Balance at April 30, 2008	<u>100</u>	<u>\$ 100</u>	<u>4,675</u>	<u>1,957</u>	<u>\$ (20,880)</u>	<u>358</u>	<u>54,591</u>	<u>54,698</u>

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, 2007

(In thousands)

	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, 2006	11,559	\$ 11,559	900	\$ 900	190	\$ 2,375	25	\$ 498	—	\$ —
Issuance of common stock in connection with purchase of customer lists	14	14	—	—	—	—	—	—	—	—
Exercise of warrants (note 10)	463	463	—	—	—	—	—	—	—	—
Exercise of stock options (note 11)	165	165	—	—	—	—	—	—	—	—
Balance at April 30, 2007	12,201	\$ 12,201	900	\$ 900	190	\$ 2,375	25	\$ 498	—	\$ —

	Exchangeable shares		Common stock committed to be issued		Additional paid-in capital	Treasury stock		Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount	Shares	Amount		Shares	Amount			
Balance at May 1, 2006	100	\$ 100	4	\$ 16	6,233	681	\$ (1,428)	339	21,995	42,587
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	—	—	(4)	(16)	102	—	—	—	—	100
Exercise of warrants (note 10)	—	—	—	—	(463)	—	—	—	—	—
Exercise of stock options (note 11)	—	—	—	—	143	—	—	—	—	308
Stock-based compensation expense (note 11)	—	—	—	—	251	—	—	—	—	251
Stock option income tax benefit (note 9)	—	—	—	—	242	—	—	—	—	242
Repurchase of outstanding stock	—	—	—	—	—	159	(1,531)	—	—	(1,531)
Net income	—	—	—	—	—	—	—	—	15,730	15,730
Foreign currency translation adjustment, net	—	—	—	—	—	—	—	35	—	35
Comprehensive income	—	—	—	—	—	—	—	—	—	15,765
Balance at April 30, 2007	100	\$ 100	—	\$ —	6,508	840	\$ (2,959)	374	37,725	57,722

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

(In thousands)

	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	11,002	\$ 11,002	900	\$ 900	190	\$ 2,375	25	\$ 498	—	\$ —	
Issuance of common stock in connection with purchase of customer lists	4	4	—	—	—	—	—	—	—	—	
Exercise of warrants (note 10)	243	243	—	—	—	—	—	—	—	—	
Exercise of stock options (note 11)	310	310	—	—	—	—	—	—	—	—	
Balance at April 30, 2006	<u>11,559</u>	<u>\$ 11,559</u>	<u>900</u>	<u>\$ 900</u>	<u>190</u>	<u>\$ 2,375</u>	<u>25</u>	<u>\$ 498</u>	<u>—</u>	<u>\$ —</u>	

	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	\$ 100	8	\$ 32	1,680	3,644	646	\$ (1,288)	205	13,724	32,872
Issuance of common stock and common stock committed to be issued in connection with purchase of customer lists	—	—	(4)	(16)	—	76	—	—	—	—	64
Adoption of FASB statement No. 150 (note 10)	—	—	—	—	(1,680)	1,680	—	—	—	—	—
Exercise of warrants (note 10)	—	—	—	—	—	61	—	—	—	—	304
Exercise of stock options (note 11)	—	—	—	—	—	302	—	—	—	—	612
Stock option income tax benefit (note 9)	—	—	—	—	—	470	—	—	—	—	470
Repurchase of outstanding stock	—	—	—	—	—	—	35	(140)	—	—	(140)
Net income	—	—	—	—	—	—	—	—	—	8,271	8,271
Foreign currency translation adjustment, net	—	—	—	—	—	—	—	—	134	—	134
Comprehensive income	—	—	—	—	—	—	—	—	—	—	8,405
Balance at April 30, 2006	<u>100</u>	<u>\$ 100</u>	<u>4</u>	<u>\$ 16</u>	<u>—</u>	<u>6,233</u>	<u>681</u>	<u>\$ (1,428)</u>	<u>339</u>	<u>21,995</u>	<u>42,587</u>

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, 2008, 2007 and 2006

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:			
Net income	\$ 16,866	15,730	8,271
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change	—	—	1,656
Depreciation and amortization	4,788	2,945	1,869
Write-down of impaired customer lists	187	218	344
Amortization of deferred financing costs and original issue discount	—	113	207
Tax benefit of stock option exercises	—	—	470
Stock-based compensation	869	251	—
Provision for doubtful accounts and franchise fee refunds	5,374	6,346	5,479
Gain on sale of intangible assets and property and equipment, net	(841)	(196)	(107)
Loss on early extinguishment of debt	—	886	—
Accrued interest on subordinated debt	—	321	627
Deferred tax expense (benefit)	379	373	(680)
Unrealized loss on short-term investments	19	—	—
Realized gain on short-term investments	(23)	—	—
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:			
Trade accounts receivable	(12,133)	(9,870)	(12,177)
Notes receivable	(1,357)	(2,370)	(8,518)
Refund anticipation loan fees	536	(1,236)	(298)
Interest receivable	(819)	(1,203)	(549)
Prepaid expenses and other current assets	(188)	1,004	1,554
Other assets	(108)	143	(18)
Accounts payable and accrued expenses	3,600	3,220	6,927
Dividend receivable	(51)	—	—
Income taxes payable	3,211	3,149	3,409
Deferred franchise fees and franchise deposits	4,327	897	3,610
Net cash provided by operating activities	<u>24,636</u>	<u>20,721</u>	<u>12,076</u>
Cash flows from investing activities:			
Issuance of operating loans to franchisees	(13,710)	(12,457)	(8,412)
Payments received on operating loans from franchisees	12,232	9,789	6,531
Purchases of customer lists and other assets	(2,368)	(1,374)	(749)
Payments issued in conjunction with exchanges of territories	—	—	(193)
Proceeds from sale of customer lists and other assets	879	546	294
Proceeds from sale of short-term investments	806	69	3
Purchases of short-term investments	(10,121)	—	(40)
Purchases of property and equipment	(1,737)	(6,196)	(2,491)
Increase (decrease) in cash from consolidation (deconsolidation) of VIEs	—	(174)	174
Net cash used in investing activities	<u>(14,019)</u>	<u>(9,797)</u>	<u>(4,883)</u>
Cash flows from financing activities:			
Proceeds from the exercise of stock options and warrants	1,319	308	916
Proceeds from issuance of long-term debt	—	17,600	—
Repayment of long-term debt	(16,286)	(20,050)	(986)
Repurchase of outstanding stock and stock options	(22,659)	(1,531)	(140)
Net borrowings under lines of credit	9,838	—	—
Payment for debt issuance costs	(861)	—	—
Tax benefit of stock option exercises	541	242	—
Net cash used in financing activities	<u>(28,108)</u>	<u>(3,431)</u>	<u>(210)</u>
Effect of exchange rate changes on cash, net	(493)	(1)	(596)
Net increase (decrease) in cash and cash equivalents	<u>(17,984)</u>	<u>7,492</u>	<u>6,387</u>
Cash and cash equivalents at beginning of year	20,914	13,422	7,035
Cash and cash equivalents at end of year	<u>\$ 2,930</u>	<u>20,914</u>	<u>13,422</u>

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

Consolidated Statements of Cash Flows
Years ended April 30, 2008, 2007 and 2006

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 2,357	3,869	2,458
Cash paid for taxes	\$ 6,958	4,565	7,829
Supplemental disclosures of noncash investing and financing activities:			
During the years ended April 30, 2008, 2007 and 2006, the Company acquired certain assets from franchisees as follows:			
Fair value of assets purchased	\$ 6,412	6,909	4,352
Receivables forgiven	(6,132)	(9,620)	(6,276)
Accounts payable cancelled	1,449	775	277
Liabilities assumed	(47)	(66)	(196)
Notes payable issued	—	(120)	(246)
Deferred revenue recognized	682	3,373	2,670
Common stock issued	(30)	(100)	—
Applied from sales of franchise territories	34	223	168
Cash paid to seller	\$ 2,368	1,374	749
During the year ended April 30, 2008, 2007 and 2006, the Company sold certain assets to franchisees as follows:			
Book value of assets sold	\$ 4,162	5,618	2,883
Gain (loss) on sale	476	(152)	106
Deferred gain on sale	1,218	2,145	217
Applied from acquisitions of franchise territories	(248)	98	—
Notes issued	(4,729)	(7,163)	(2,912)
Cash received	\$ 879	546	294

In 2007, the Company purchased an online tax preparation software application for \$9,406, including direct costs of the acquisition. The purchase price was paid as follows: \$2,748 in cash and \$6,597 through the issuance of a term note payable

In 2006, certain franchisees exchanged their existing territories for others. In conjunction with these transactions, the Company recorded intangible assets of \$493, receivables of \$1,365, recorded deferred revenue of \$579 and recognized franchise fees of \$1,086. Cash of \$193 was paid by the Company in conjunction with these exchanges

See accompanying notes to consolidated financial statements.

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

Notes to Consolidated Financial Statements

April 30, 2008, 2007 and 2006

(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 also offers online tax preparation services. The Company was formed in October 1996 as a Delaware corporation.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of JTH Tax, Inc. and its wholly owned subsidiaries. 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 accordance with the Financial Accounting Standards Board (FASB) Interpretation No. 46(R), *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46R), the Company also consolidates any variable interest entities (VIEs) of which it is the primary beneficiary, as defined. All significant intercompany balances and transactions have been eliminated in consolidation.

(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) Short-term Investments

Short-term investments consist of equity securities and related dividends receivable. The Company has classified these investments as trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Trading securities are recorded at fair value with changes in fair value reported within the consolidated statements of income.

(e) 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.

JTH TAX, INC. AND SUBSIDIARIES
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Notes to Consolidated Financial Statements

April 30, 2008, 2007 and 2006

(f) 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 that 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.

(g) Property, Equipment and Software

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

(h) Goodwill

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*. 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 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. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

During 2008, 2007, and 2006, the Company performed its annual impairment review of goodwill and concluded that there was no impairment.

(i) 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.

JTH TAX, INC. AND SUBSIDIARIES
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Notes to Consolidated Financial Statements

April 30, 2008, 2007 and 2006

(j) **Treasury Stock**

Treasury stock is accounted for under the cost method.

(k) **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.

(l) **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.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more-likely-than-not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. FIN 48 requires the recognition of interest, if the tax law would require interest to be paid on the underpayment of taxes, and recognition of penalties, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties. Penalties and interest may be classified as either penalties and interest expense or income tax expense. Management has elected to classify accrued interest in interest expense and accrued penalties in general and administrative expenses. The Company adopted the provisions of FIN 48 effective May 1, 2006.

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Notes to Consolidated Financial Statements

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(m) Long-Lived Assets

In accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, 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. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. 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.

(n) 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 and comprehensive income.

(o) Stock-Based Compensation

Prior to 2007, the Company applied 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 stock options granted under its stock option plan. As such, compensation expense would have been recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Accordingly, no compensation costs were recognized in the accompanying consolidated statements of income prior to 2007 on stock options granted, since all options granted under the Company's stock option plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective May 1, 2006, the Company adopted FASB Statement No. 123(R), *Share-Based Payment* (Statement 123(R)). This statement replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (Statement 123) and supersedes APB No. 25. Statement 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This statement was adopted using the modified prospective method of application, which requires the Company to recognize compensation cost on a prospective basis. Therefore, prior years' financial statements have not been restated. Under this method, the Company records stock-based compensation expense for awards granted prior to, but not yet vested as of May 1, 2006, using the fair value amounts determined for pro forma disclosures under Statement 123. For stock-based awards granted after May 1, 2006, the Company recognizes compensation expense based on estimated grant date fair value using the Black-Scholes

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option-pricing model and the compensation expense is included in income from continuing operations.

The following table illustrates the effect on net income for the year ended April 30, 2006 as if the Company had applied the fair value recognition provisions of Statement 123(R) to options granted under the Company's stock plans prior to adoption of Statement 123(R) on May 1, 2006. No pro forma disclosure has been made for periods subsequent to April 30, 2006 as all stock-based compensation has been recognized in net income. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and amortized to expense over the options' service periods with forfeitures recognized as they occurred.

(In thousands)

Net income available to common stockholder – as reported	\$ 8,271
Less pro forma stock compensation cost, net of tax benefit	<u>1,037</u>
Pro forma net income available to common stockholders	<u><u>\$ 7,234</u></u>

In a change from previous standards, Statement 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows. Excess tax benefits related to stock option exercises in 2006 are reflected in operating activities.

(p) 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles. Actual results could differ from those estimates.

(q) Reclassification

Certain 2007 and 2006 amounts have been reclassified to conform to the 2008 financial statement presentation.

(r) Recently Issued Accounting Standards

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115* (Statement 159). Statement 159 gives the company the irrevocable option to carry most financial assets and liabilities at fair value that are not currently required to be measured at fair value. If the fair value option is elected, changes in fair value would be recorded in earnings at each subsequent reporting date. Statement 159 is effective for the Company beginning on May 1, 2008. The Company is currently evaluating the impact the adoption of this statement could have on its financial position, results of operations and cash flows.

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In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurement* (Statement 157). Statement 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosure about fair value measurements. The Statement does not require any new fair value measures. The Statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. The Company is required to adopt Statement 157 beginning on May 1, 2008. Statement 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to opening retained earnings in the year of adoption. In November 2007, the FASB proposed a one-year deferral of Statement 157's fair-value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. The Company is currently evaluating the impact of adopting Statement 157 on its financial position and results of operations.

(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 12%. Transactions for 2008 and 2007 are as follows:

(In thousands)	2008	2007
Balance at beginning of year	\$ 55,804	48,707
Impact of deconsolidating VIEs	—	3,284
Notes issued:		
Sales of franchise territories	22,315	17,311
Sales of Company-owned stores	3,801	7,163
Franchisee to franchisee note assumptions	2,793	2,675
Operating loans to franchisees	13,710	12,457
Refinancing of notes and accounts receivable	4,956	4,583
Repayment of notes	(31,380)	(26,141)
Notes cancelled	(11,804)	(14,237)
Foreign currency adjustment	303	2
Balance at end of year	\$ 60,498	55,804

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 both the performance of the tax preparation industry as a whole and the individual franchisee. 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.

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At April 30, 2008 and 2007, the Company had an investment in impaired notes and related interest receivable of \$7,728,000 and \$8,434,000 respectively, which had recorded values that exceeded the fair value of the underlying collateral by approximately \$455,000 and \$1,014,000 respectively. In addition, the Company had trade accounts receivable due from these franchisees of \$3,204,000 and \$2,570,000 at April 30, 2008 and 2007, respectively. The Company has reflected an allowance of \$3,659,000 and \$3,584,000 respectively, for this impairment in the accompanying consolidated balance sheets. Activity in the allowance for doubtful accounts for the years ended April 30, 2008 and 2007 is summarized as follows:

(In thousands)	<u>2008</u>	<u>2007</u>	<u>2006</u>
Beginning balance	\$ 5,177	3,083	2,744
Impact of (consolidating) and deconsolidating VIEs	—	431	(71)
Additions charged to expense	3,553	4,472	4,149
Provision for franchise fee refunds	1,821	1,874	1,330
Write-offs	(4,733)	(4,683)	(5,112)
Foreign currency adjustment	47	—	43
Ending balance	<u>\$ 5,865</u>	<u>5,177</u>	<u>3,083</u>

The Company's average investment in impaired notes receivable during the years ended April 30, 2008 and 2007 was \$8,100,000 and \$7,433,000 respectively. Interest income related to impaired notes was \$417,000, \$1,406,000 and \$746,000 for the years ended April 30, 2008, 2007 and 2006, respectively. The Company's investment in notes receivable on nonaccrual status as of April 30, 2008 and 2007 was \$9,892,000 and \$11,573,000 respectively.

(3) Property, Equipment and Software, Net

Property, equipment and software, net consists of the following at April 30, 2008 and 2007:

(In thousands)	<u>2008</u>	<u>2007</u>
Land	\$ 799	799
Buildings	3,653	3,420
Leasehold improvements	212	124
Furniture, fixtures and equipment	3,512	3,380
Software	<u>18,003</u>	<u>17,880</u>
	26,179	25,603
Less accumulated depreciation and amortization	<u>7,658</u>	<u>5,186</u>
Property, equipment and software, net	<u>\$ 18,521</u>	<u>20,417</u>

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 \$7,383,000

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and \$6,994,000 at April 30, 2008 and 2007, respectively, and have been included in property, equipment and software in the accompanying consolidated balance sheets. The Company placed this software in service and began amortizing in 2007.

(4) Other Intangible Assets, Net

Other intangible assets, net consist of the following at April 30, 2008 and 2007:

(In thousands)	<u>Amortization period</u>	<u>2008</u>	<u>2007</u>
Customer lists	5 years	\$ 3,801	3,360
Area franchise rights	10 years	3,333	841
		<u>7,134</u>	<u>4,201</u>
Less accumulated amortization		<u>1,186</u>	<u>771</u>
Intangible assets, net		<u>\$ 5,948</u>	<u>3,430</u>

Amortization and impairment charges for the years ended April 30, 2008, 2007 and 2006 were \$1,331,000, \$1,104,000 and \$1,127,000, respectively. Estimated amortization expense for the next five years is \$1,094,000 in 2009, \$1,088,000 in 2010, \$1,026,000 in 2011, \$894,000 in 2012 and \$552,000 in 2013.

(5) Leases

The Company is obligated under various operating leases for office space that expire at various dates. Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of April 30, 2008 are:

Year ending April 30:	<u>(In thousands)</u>
2009	\$ 1,798
2010	1,106
2011	740
2012	483
2013	179
Thereafter	<u>96</u>
Total minimum lease payments	<u>\$ 4,402</u>

The Company has subleases under certain of these commitments as of April 30, 2008 amounting to \$906,000 in 2009, \$594,000 in 2010, \$419,000 in 2011, \$280,000 in 2012, \$88,000 in 2013 and \$14,000 thereafter.

Total rent expense for operating leases, net of subleases, was approximately \$1,373,000, \$1,238,000 and \$1,707,000 for the years ended April 30, 2008, 2007 and 2006, respectively.

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(6) Line of Credit

At April 30, 2007, the Company had a line of credit with a financial institution, which allowed for borrowings up to \$25,000,000 and accrued interest at LIBOR plus 1.45%. The line was collateralized by all the assets of the Company and was scheduled to expire on July 31, 2008. There were no borrowings against the line at April 30, 2007. In June 2007, this line of credit was renegotiated with the bank to allow borrowings up to \$60,000,000 at LIBOR plus 1.45% and was scheduled to expire on August 31, 2009.

During February 2008, the Company replaced the line of credit described above with a syndicated line of credit with ten financial institutions, which allows for borrowings up to \$100,000,000 and accrues interest at LIBOR plus 1.375%. The line is collateralized by all the assets of the Company and expires on March 31, 2013. There were borrowings of \$9,838,000 against the line at April 30, 2008. The line of credit contains certain financial covenants, which the Company must meet, including leverage and fixed charge coverage ratios as well as minimum net worth requirements and capital expenditure limitations.

During 2007, the Company had 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 allowed for borrowings up to \$20,000,000 and \$5,000,000, respectively, and accrued interest at Canadian LIBOR plus 3%. There were no borrowings against either line at April 30, 2007. Both lines expired on May 31, 2007 and were collateralized by all the assets of the Company. In June 2007, the discounting line and the guidance facility were renegotiated to be included in the \$60,000,000 line of credit discussed above.

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(7) Long-Term Debt

Long-term debt at April 30, 2008 and 2007 consists of the following:

(In thousands)	2008	2007
Mortgage note payable to a bank in monthly installments of \$1 including interest at 8.50%; collateralized by land and building.	\$ —	112
Mortgage note payable to a bank in monthly installments of \$1 including interest at 9.25%; collateralized by land and building.	—	95
Mortgage note payable to a bank in monthly installments of \$16 including interest at 6.06% through September 2016; collateralized by land and building.	2,553	2,583
Notes payable for acquired stores, interest rates ranging from 8% to 12%; due May 2008 through January 2011.	203	504
Term note payable including interest at LIBOR plus 2.5%; collateralized by all assets of the Company.	—	500
Term note payable including interest at LIBOR plus 2.25%; collateralized by all assets of the Company (note 8).	—	13,500
Term note payable for software purchase, payable in three annual installments of \$2,000 at 0% interest beginning December 2007; interest has been imputed at 8%.	3,552	5,300
Total long-term debt	6,308	22,594
Less current installments	1,922	6,014
Total long-term debt, less current installments	\$ 4,386	16,580

Aggregate maturities of long-term debt as of April 30, 2008 are as follows:

Year ending April 30:	(In thousands)
2009	\$ 1,922
2010	1,892
2011	45
2012	38
2013	41
Thereafter	2,370
Total long-term debt	\$ 6,308

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(8) Subordinated Debt

In November 2004, the Company entered an agreement to borrow \$15,000,000 from a group of lenders. The loan bore 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 \$627,000 for the year ended April 30, 2006 and was recorded as an increase to subordinated debt. Deferred financing costs incurred in securing the loan were amortized over its life using the effective interest method. The loan was refinanced in November 2006 as a part of the term loan agreement described in note 7. Because the refinancing constituted a debt extinguishment for accounting purposes, the remaining related financing costs were expensed in 2007 and reflected as a loss on extinguishment of debt.

Interest expense totaling \$114,000 and \$207,000 was recorded in 2007 and 2006, respectively, related to the amortization of deferred financing costs.

(9) Income Taxes

Total income taxes were allocated as follows:

(In thousands)	<u>2008</u>	<u>2007</u>	<u>2006</u>
Income from continuing operations	\$ 11,114	8,324	7,111
Stockholders' equity, tax benefit on exercise of stock options	(541)	(242)	(470)
Foreign currency translation adjustment	238	—	—
Total income taxes	<u>\$ 10,811</u>	<u>8,082</u>	<u>6,641</u>

Components of income tax expense for the years ended April 30, 2008, 2007 and 2006 were as follows:

(In thousands)	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal	\$ 8,392	6,415	5,868
State	1,530	1,273	1,397
Foreign	813	263	526
Current tax expense	<u>10,735</u>	<u>7,951</u>	<u>7,791</u>
Deferred:			
Federal	324	301	(512)
State	59	60	(122)
Foreign	(4)	12	(46)
Deferred tax expense (benefit)	<u>379</u>	<u>373</u>	<u>(680)</u>
Total income tax expense	<u>\$ 11,114</u>	<u>8,324</u>	<u>7,111</u>

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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 2008, 2007 and 2006) differs from tax expense for the years ended April 30, 2008, 2007 and 2006 as follows:

(In thousands)	<u>2008</u>	<u>2007</u>	<u>2006</u>
Computed "expected" income tax expense	\$ 9,793	8,419	5,963
Increase (decrease) in income taxes resulting from:			
State income taxes, net of federal benefit	1,033	897	889
Change in taxes resulting from permanent differences, net	270	256	76
Impact of nontaxable VIEs	—	(918)	357
Other	18	(330)	(174)
Total income tax expense	<u>\$ 11,114</u>	<u>8,324</u>	<u>7,111</u>

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, 2008 and 2007 are as follows:

(In thousands)	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Unexercised non-qualified options	\$ 181	—
Accounts payable and accrued liabilities	146	174
Allowance for doubtful accounts	2,727	2,566
Total deferred tax assets	<u>3,054</u>	<u>2,740</u>
Deferred tax liabilities:		
Property, equipment and software and other intangible assets	2,923	1,838
Deferred revenue	8,534	9,020
Prepaid expenses	211	117
Foreign currency translation adjustment	238	—
Total deferred tax liabilities	<u>11,906</u>	<u>10,975</u>
Net deferred tax liability	<u>\$ (8,852)</u>	<u>(8,235)</u>

As a result of adopting FIN 48 on May 1, 2006, the Company reclassified approximately \$8,456,000 from income taxes payable to deferred income taxes.

In assessing the realizability of the gross deferred tax assets, management considers whether it is more likely than not that some portion or 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

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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.

In April 2008, the Internal Revenue Service completed audits of 2005 and 2006. As of April 30, 2008, the years that remain subject to examination by the Internal Revenue Service are 2007 and subsequent years, and years that remain open for other major taxing jurisdictions are 2005 and subsequent years.

(10) Stockholders' Equity

(a) Preferred Stock and Exchangeable Shares

The Company has 3,200,000 shares of authorized preferred stock with 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 \$5,600,000 and \$5,091,000 as of April 30, 2008 and 2007, respectively. Its carrying amount was \$2,375,000 at April 30, 2008 and 2007.

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 10 shares of fully paid and nonassessable shares of Class A common stock.

During 2008, the Company reacquired all outstanding shares of Class B preferred stock and dissolved this class of stock.

In October 2001, the Company acquired the remaining 40% of the outstanding common stock of the Canadian subsidiary in a transaction which was accounted for as a purchase. The Company issued consideration to the minority shareholder consisting of 1,600,000 shares of Class A common stock, 10 shares of special voting preferred stock and 100,000 shares of exchangeable shares in exchange for \$2,000,000 in cash and the 40% minority interest in the Canadian subsidiary. The 100,000 exchangeable shares are exchangeable at any time at a 10:1 ratio into the Class A common stock of the Company. The special voting preferred shares issued have a \$1 par value and no liquidation value and entitle the holder to vote each share as if it represented 100,000 shares of Class A common stock. These shares will be cancelled as the holder exchanges the exchangeable shares.

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(b) Common Stock

The Company is authorized to issue 21,200,000 shares of Class A common stock, par value \$1 per share and 1,000,000 shares of Class B common stock, par value \$1 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 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 2008 and 2007, in connection with the acquisition of franchises from existing franchisees, the Company issued a total of 4,000 and 10,000 shares, respectively, of Class A common stock. In conjunction with a transaction that occurred in 2003, the Company agreed to issue 16,000 additional shares over the next five years at \$4 per share. This obligation was previously reflected in the accompanying consolidated balance sheets as shares committed to be issued, but was fully satisfied during 2007.

(c) Warrants and put option

In July 2001, the Company issued 463,400 warrants to purchase Class A common stock to a venture capital group. These warrants were exercisable immediately upon issuance at an exercise price of \$0.00001 per share and were exercised in 2007. The warrants were issued in conjunction with a freestanding put option which allowed 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 was set to expire 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 \$1,680,000 as of April 30, 2005.

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 was within the scope of this statement, and its fair value had an insignificant value.

During 2008, the underlying Class A common stock related to the put option was repurchased by the Company which eliminated the put option.

In June 2001, the Company issued 260,590 warrants to officers and directors in conjunction with short-term loans to the Company which were repaid in fiscal year 2002. All of these warrants had been exercised as of April 30, 2006.

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(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 5,500,000 shares of Class A common stock have been authorized for grant under the Plan. At April 30, 2008, approximately 1,686,000 shares of Class A common stock are available for grant under the Plan. Stock options vest from six months to five years and generally expire five years from the vesting date.

The weighted average fair value of each option granted in 2008 was \$2.46 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 11.04% – 15.93%, risk-free interest rates of 3.77% – 4.87% and expected lives of four to six years. There were no options granted in 2007. The weighted average fair value of each option granted in 2006 was \$1.70 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 following table summarizes all stock option activity during the periods indicated:

	Number of options	Weighted average exercise price
Outstanding at April 30, 2005	1,980,280	\$ 4.39
Granted	754,700	8.74
Exercised	(310,180)	1.98
Cancelled	(31,700)	7.28
Outstanding at April 30, 2006	2,393,100	6.04
Granted	—	—
Exercised	(165,350)	1.82
Cancelled	(163,500)	6.59
Outstanding at April 30, 2007	2,064,250	6.34
Granted	530,120	10.87
Exercised	(373,450)	3.53
Cancelled	(108,550)	8.60
Outstanding at April 30, 2008	<u>2,112,370</u>	7.85

All stock options were granted to employees of the Company except for options issued to nonemployee directors. Nonemployee directors were granted a total of 50,000 stock options during the year ended April 30, 2008 and a total of 130,000 stock options during the year ended April 30, 2006. No stock options were issued to nonemployee directors in 2007.

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The following table summarizes nonvested stock option activity during the periods indicated:

	Nonvested options outstanding	Weighted average exercise price
Outstanding at April 30, 2005	373,332	\$ 6.65
Granted	145,000	8.69
Vested	(156,668)	7.15
Cancelled	—	—
Outstanding at April 30, 2006	361,664	7.26
Granted	—	—
Vested	(135,000)	7.05
Cancelled	(120,000)	7.50
Outstanding at April 30, 2007	106,664	7.25
Granted	265,000	11.21
Vested	(163,332)	9.02
Cancelled	(11,666)	9.00
Outstanding at April 30, 2008	196,666	11.17

At April 30, 2008, there was \$592,000 of total unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized between 2009 and 2011.

The following tables summarize information about stock options outstanding and exercisable at April 30, 2008:

Number of shares outstanding at April 30, 2008	Range of exercise prices	Weighted average exercise price	Weighted average remaining contractual life	Number of shares exercisable at April 30, 2008	Weighted average exercise price
247,800	\$ 4.00 – 4.40	4.06	31 days	247,800	4.06
582,400	5.50 – 6.88	6.05	1.9 years	582,400	6.05
160,000	7.00 – 7.50	7.25	2.7 years	160,000	7.25
359,000	8.50 – 9.00	8.55	2.6 years	352,334	8.54
260,150	9.00 – 9.90	9.03	3.0 years	260,150	9.03
503,020	10.50 – 15.00	10.89	5.2 years	313,020	10.67

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(12) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at April 30, 2008. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties.

Cash and cash equivalents, trade accounts receivable, refund anticipation loan fees, other current assets, accounts payable and accrued expenses, deferred franchise fees and franchise deposits: The carrying amounts approximate fair value because of the short maturity of these instruments.

Notes receivable: The carrying amount of the Company's notes receivable approximates fair value based upon the present value of expected future cash flows discounted at the interest rate currently offered by the Company, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk.

Long-term debt: The carrying amount of the Company's long-term debt approximates fair value based on the present value of expected future cash flows discounted at the interest rates offered by the lenders, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk.

Financial instruments that could potentially subject the Company to concentrations of credit risks consist of accounts and notes receivable with its franchisees. The Company manages such risk by evaluating the financial position, value of the franchises as well as the personal guarantee of the individual franchisees. As of April 30, 2008, there were no significant concentrations of credit risk associated with any individual franchisee or group of franchisees. The Company maintains an allowance for potential losses based on its expected collectibility of the receivables, which the Company believes is adequate for its credit loss exposure.

(13) Employee 401(k) Plan

The Company sponsors a defined contribution 401(k) profit sharing plan. Under the plan, employees who are 18 years of age and have completed 90 days of service are eligible to make voluntary contributions to the plan. The Company matches 50% of each employee's contribution up to 6% of the employee's salary. Total compensation expense related to these contributions was \$240,000 and \$97,000 for the years ended April 30, 2008 and 2007, respectively. The Company did not make contributions to the plan during the year ended April 30, 2006.

(14) Commitments and Contingencies

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, 2008.

JTH TAX, INC. AND SUBSIDIARIES
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Notes to Consolidated Financial Statements

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(15) Variable Interest Entities

FIN 46R requires the consolidation of a 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 VIEs. 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 VIE. 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 may 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 until a reconsideration event, as defined in FIN 46R, occurs to require deconsolidation of the VIE. At the deconsolidation date, the assets and liabilities of the VIE are removed from the consolidated financial statements and any assets and liabilities of the Company that were eliminated in consolidation are restored. The gain recognized from deconsolidating VIEs is recorded in the consolidated statements of income as gain on deconsolidation of VIEs.

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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 accompanying consolidated statement of income for the year ended April 30, 2006 is as follows:

(In thousands)	JTH Tax, Inc. and subsidiaries	VIEs	Consolidating adjustments and eliminations	Consolidated
Revenue	\$ 64,281	2,773	(902)	66,152
Operating expenses	46,102	3,845	(1,238)	48,709
Other, net	(458)	—	53	(405)
Income (loss) before income taxes and cumulative effect of accounting change	17,721	(1,072)	389	17,038
Income tax expense	7,111	—	—	7,111
Income (loss) before cumulative effect of accounting change	10,610	(1,072)	389	9,927
Cumulative effect of accounting change	—	—	(1,656)	(1,656)
Net income (loss)	\$ 10,610	(1,072)	(1,267)	8,271

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(In thousands)

During 2007, a reconsideration event occurred for each of the 16 VIEs consolidated at April 30, 2006. The operating results of each VIE, through its deconsolidation date, are consolidated in the accompanying consolidated statement of income for the year ended April 30, 2007. The Company was not deemed to be the primary beneficiary of any additional VIEs during 2007 and there are no VIEs consolidated at April 30, 2007. The summarized effect of these entities in the accompanying consolidated statement of income for the year ended April 30, 2007 is as follows:

(In thousands)	JTH Tax, Inc. and subsidiaries	VIEs	Consolidating and deconsolidating adjustments and eliminations	Consolidated
Revenue	\$ 74,990	578	(420)	75,148
Operating expenses	53,293	1,294	(420)	54,167
Other, net	18	—	—	18
Gain on deconsolidation of VIEs	—	—	3,055	3,055
Income (loss) before income taxes	21,715	(716)	3,055	24,054
Income tax expense	8,324	—	—	8,324
Net income (loss)	<u>\$ 13,391</u>	<u>(716)</u>	<u>3,055</u>	<u>15,730</u>

(16) Subsequent Events

On June 16, 2008, the Company authorized the grant of 450,000 stock options to certain employees and 50,000 stock options to the non-employee directors of the Company. The exercise price of these options will be \$15 per share, which management believes was the fair value at the date of the grant. Most of the options will vest after six months and may be exercised over a five-year period.