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Department of the Treasury
Internal Revenue Service
24000 Avila Road, Stop 5916
Laguna Niguel, CA 92677-3405

ORIGINAL

Letter Number: 531(DO)

Exhibit C

Date:

OCT 06 2006

Form: 1040

Taxpayer Identifying Number:

J. Winston Krause and
Sheri S Krause
P.O. Box 5899
Austin, TX 78768-5899

Person to Contact: Notices Clerk
Telephone Number: (949) 889-4515
Refer Reply to: E:TS:TEFRA West
Last Date to File a Petition with the
United States Tax Court:

JAN 04 2007

Penalty Code Sections

Tax Year Ended	Deficiency	6662(h)
December 31, 2002	\$155,439.00	\$62,175.60
December 31, 2003	\$27,443.00	\$31,082.00

Dear J. Winston Krause and Sheri S Krause:

NOTICE OF DEFICIENCY

We have determined that you owe additional tax or other amounts, or both, for the tax year(s) identified above. This letter is your **NOTICE OF DEFICIENCY**, as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this determination in court before making any payment, you have 90 days from the date of this letter (150 days if this letter is addressed to you outside the United States) to file a petition with the United States Tax Court for a redetermination of the deficiency. You can get a copy of the rules for filing a petition and a petition form you can use by writing to the address below:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

The Tax Court has a simplified procedure for small tax cases when the amount in dispute for each tax year is \$50,000 or less. If you intend to file a petition for multiple tax years and the amount in dispute for any one or more of the tax years exceeds \$50,000, this simplified procedure is not available to you. If you use this simplified procedure, you cannot appeal the Tax Court's decision. You can get information pertaining to the simplified procedure for small cases from the Tax Court by writing to the court at the above address or from the court's Internet site at www.ustaxcourt.gov.

Send the completed petition form, a copy of this letter, and copies of all statements and/or schedules you received with this letter to the Tax Court at the above address. The Court cannot consider your case if the petition is filed late. The petition is considered timely if the postmark date falls within the prescribed 90 or 150 day period and the envelope containing the petition is properly addressed with the correct postage.

The time you have to file a petition with the court is set by law and cannot be extended or suspended. Thus, contacting the Internal Revenue Service (IRS) for more information or receiving other correspondence from the IRS won't change the allowable period for filing a petition with the Tax Court.

As required by law, separate notices are sent to husbands and wives. If this letter is addressed to both husband and wife, and both want to petition the Tax Court, both must sign and file the petition or each must file a separate, signed petition. If more than one year is shown above, you may file one petition form showing all of the years you are contesting.

You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before the Tax Court.

If you decide not to file a petition with the Tax Court, please sign the enclosed waiver form and return it to us at the IRS address on the top of the first page of this letter. This will permit us to assess the deficiency quickly and can help limit the accumulation of interest.

If you decide not to sign and return the waiver, and you do not file a petition with the Tax Court within the time limit, the law requires us to assess and bill you for the deficiency after 90 days from the date of this letter (150 days if this letter is addressed to you outside the United States).

NOTE: If you are a C-corporation, Section 6621(c) of the Internal Revenue Code requires that we charge an interest rate two percent higher than the normal rate on corporate underpayments in excess of \$100,000.

If you have questions about this letter, you may write to or call the contact person whose name, telephone, and IRS address are shown on the front of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this notice of deficiency. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

Thank you for your cooperation.

Sincerely,
Mark W. Everson
Commissioner
By

A handwritten signature in black ink, appearing to read "Tim C. [unclear]", is written over a dark, textured rectangular stamp.

Technical Services
Territory Manager
Western Territory

Enclosures:
Explanation of tax changes
Waiver

Letter 531 (D) (Rev. 6-2003)
Catalog Number 40222A

PL0008

Form 4549-A (Rev. March 2005)	Department of the Treasury-Internal Revenue Service Income Tax Discrepancy Adjustments	Page <u>1</u> of <u>2</u>	
Name and Address of Taxpayer J Winston & Sheri S Krause PO Box 5399 Austin TX 78763-5399		Taxpayer Identification Number [REDACTED]	
		Return Form No.: 1040	
		Person with whom examination changes were discussed.	
		Name and Title:	
1. Adjustments to Income	Period End 12/31/2002	Period End 12/31/2003	Period End
a. Sch E-Income, Partnership: KAAS LC	(2,791,250.00)		
b. Sch E- Loss, Prtnrship: Krause & Associates LP	2,791,429.00		
c. Other Losses, Form 4797: Option A	2,791,250.00		
d. SE AGI Adjustment	(12,978.00)		
e. Itemized Deductions	(24,156.00)	83,163.00	
f. Exemptions	15,000.00		
g.			
h.			
i.			
j.			
k.			
l.			
m.			
n.			
o.			
p.			
2. Total Adjustments	2,769,295.00	83,163.00	
3. Taxable Income Per Return or as Previously Adjusted	(2,362,710.00)	208,811.00	
4. Corrected Taxable Income	406,585.00	291,974.00	
Tax Method	SCHEDULE D	SCHEDULE D	
Filing Status	Joint	Joint	
5. Tax	127,684.00	77,705.00	
6. Additional Taxes / Alternative Minimum			
7. Corrected Tax Liability	127,684.00	77,705.00	
8. Less Credits		3.00	
a. Foreign Tax Credit			
b.			
c.			
d.			
9. Balance (Line 7 less total of Lines 8a thru 8d)	127,684.00	77,702.00	
10. Plus Other Taxes	25,955.00		
a. Self Employment Tax			
b.			
c.			
d.			
11. Total Corrected Tax Liability (Line 9 plus Lines 10a thru 10d)	153,639.00	77,702.00	
12. Total Tax Shown on Return or as Previously Adjusted	0.00	50,259.00	
13. Adjustments to:			
a.			
b.			
c. Addnl Child Tax Credit	1,800.00		
14. Deficiency-Increase in Tax or (Overassessment - Decrease in Tax) (Line 11 less Line 12 adjusted by Lines 13a thru 13d)	155,439.00	27,443.00	
15. Adjustments to Prepayment Credits-Increase (Decrease)			
16. Balance Due or (Overpayment) - (Line 14 adjusted by Line 15) (Excluding interest and penalties)	155,439.00	27,443.00	
			PL0009

Form **4549-A**
(Rev. March 2005)

Department of the Treasury-Internal Revenue Service

Income Tax Discrepancy AdjustmentsPage 2 of 2Name of Taxpayer
J Winston & Sheri S KrauseTaxpayer Identification Number
[REDACTED]Return Form No.:
1040

17. Penalties/ Code Sections	Period End 12/31/2002	Period End 12/31/2003	Period End
a. IRC 6652(b)	62,175.60	31,082.00	
b.			
c.			
d.			
e.			
f.			
g.			
h.			
i.			
j.			
k.			
l.			
m.			
n.			
18. Total Penalties	62,175.60	31,082.00	
Underreporter attributable to negligence: (1981-1987) A tax addition of 50 percent of the interest due on the underpayment will accrue until it is paid or assessed.			
Underreporter attributable to fraud: (1981-1987) A tax addition of 50 percent of the interest due on the underpayment will accrue until it is paid or assessed.			
Underreporter attributable to Tax Motivated Transactions (TMT). Interest will accrue and be assessed at 120% of underpayment rate in accordance with IRC 6621(c).	0.00	0.00	
19. Summary of Taxes, Penalties and Interest:			
a. Balance due or (Overpayment) Taxes - (Line 16, Page 1)	155,439.00	27,443.00	
b. Penalties (Line 18) - computed to 07/03/2006	62,175.60	31,082.00	
c. Interest (IRC § 6601) - computed to 08/02/2006	41,771.42	7,832.87	
d. TMT Interest - computed to 08/02/2006 (on TMT underpayment)	0.00	0.00	
e. Amount due or refund - (sum of Lines a, b, c and d)	259,386.02	66,357.87	

Other Information:

Internal Revenue Code Section 6404(g), related to the suspension of interest, does not apply. Per the Gulf Opportunity Zone Act of 2005, suspension of interest for identified transactions ended retroactively December 2005.

PL0010

Examiner's Signature: Name Deborah Smyth	Employee ID: 95-05972	Office: Van Nuys	Date: 07/03/2006
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The Internal Revenue Service has agreements with state tax agencies under which information about federal tax, including increases or decreases, is exchanged with the states. If this change affects the amount of your state income tax, you should amend your state return by filing the necessary forms.

You may be subject to backup withholding if you underreport your interest, dividend, or patronage dividend income you earned and do not pay the required tax. The IRS may order backup withholding (withholding of a percentage of your dividend and/or interest payments) if the tax remains unpaid after it has been assessed and four notices have been issued to you over a 120-day period.

Name of Taxpayer	J Winston & Sheri S Krause	04/26/2006
Identification Number:	[REDACTED]	Total 6.20.00

2002 - Form 6251 - Alternative Minimum Tax Computation

1. If filing Schedule A enter tax table income, otherwise adjusted gross income	406,585.00
2. Total adjustment and preferences	9,049.00
3. Net operating loss deduction	0.00
4. Alternative tax net operating loss deduction	0.00
5. Alternative minimum taxable income (combine lines 1 thru 4)	415,634.00
6. Exemption amount	0.00
7. Subtract line 6 from line 5 (if 0 or less, enter 0)	415,634.00
8. If capital gains are reported, see line 22 from page 2	112,870.00
All others:	
If line 7 is \$175,000 or less (\$87,500 if MFS) multiply line 7 by 26%. Otherwise, multiply line 7 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	
9. Alternative minimum tax foreign tax credit	0.00
10. Tentative minimum tax. Subtract line 9 from line 8	112,870.00
11. Regular tax before credits	127,684.00
12. Alternative minimum tax	0.00

Exemption Worksheet (Line 6)

A. Exemption amount based on filing status	49,000.00
B. Alternative minimum taxable income	415,634.00
C. Enter \$112,500 (\$150,000 if married filing jointly or qualifying widow(er), \$75,000 if married filing separate)	150,000.00
D. Subtract line C from Line B	265,634.00
E. Multiply line D by 25%	66,409.00
F. Subtract line E from line A (if zero or less, enter 0)	0.00

Name of Taxpayer:	J Winston & Sheri S Krause	04/26/2006
Identification Number:	[REDACTED]	Total 6.20.00

**2002 - Form 6251 - Continuation, using Maximum Capital Gain Rates,
Computation of Line 10 when Schedule D is completed**

1. Amount from Form 6251 report, line 9	415,634.00
2. Amount from Schedule D line 18, or line 9 from worksheet (refigured for AMT)	90.00
3. Amount from Schedule D report, line 14 (refigured for AMT)	0.00
4. Amount from line 2 if no Schedule D worksheet otherwise, the smaller of the sum of 2 or 3 or Schedule D worksheet line 4.	90.00
5. Smaller of line 1 or line 4	415,544.00
6. Subtract line 5 from line 1	112,852.00
7. If line 6 is \$175,000 or less (\$87,500 if MFS) multiply line 6 by 26%. Otherwise, multiply line 6 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	0.00
8. Amount from Schedule D report, line 23 (refigured for AMT)	90.00
9. Smallest of line 1 or line 2	0.00
10. Smallest of line 8 or line 9 (not less than zero)	0.00
11. Qualified 5-year gain from Schedule D report, line 24 (refigured for AMT)	0.00
12. Smaller of line 10 or line 11	0.00
13. Multiply line 12 by 8%	0.00
14. Subtract line 12 from line 10	0.00
15. Multiply line 14 by 10%	90.00
16. Subtract line 10 from line 9	18.00
17. Multiply line 16 by 20%	0.00
18. Subtract line 9 from line 5	0.00
19. Multiply line 18 by 25%	0.00
20. Total of lines 7, 13, 15, 17, and 19	112,870.00
21. If line 1 is \$175,000 or less (\$87,500 if MFS) multiply line 1 by 26%. Otherwise, multiply line 1 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	112,878.00
22. Smaller of line 20 or 21, enter here and on line 10 of Form 6251 report	112,870.00

Name of Taxpayer: J Winston & Sheri S Krause
 Identification Number: [REDACTED]

Total

04/26/2006
 6.20.00

2002 - Child Tax Credit and Form 8812 Additional Child Tax Credit

1. Amount of credit based on qualifying children	1,800.00
2. Modified AGI	498,456.00
3. Limitation based on filing status (\$110,000 if joint; \$75,000 if single, head of household or qualifying widow(er); \$55,000 if married filing separate)	110,000.00
4. Subtract line 3 from line 2 (not less than 0) (If the result is not a multiple of \$1,000 increase it to the next multiple of \$1,000.)	389,000.00
5. Multiply line 4 by .05	19,450.00
6. Subtract line 5 from line 1 (If 0 or less, no credit is allowed.)	0.00
7. Corrected tax before allowable credits	0.00
8. Credit limitation	0.00
9. Subtract line 8 from line 7	0.00
10. Child Tax Credit (smaller of line 6 or 9)	0.00

Form 8812 - Additional Child Tax Credit

1. Amount from line 1 above (or amount of credit after modified AGI reduction)	0.00
2. Child Tax Credit allowed (line 10 above)	0.00
3. Subtract line 2 from line 1 (If zero or less, no credit is allowed.)	0.00
4. Total taxable earned income	0.00
5. If the amount on line 4 is more than \$10,350, subtract \$10,350 from line 4 (If line 4 is less than \$10,350, then set to zero.)	0.00
6. Multiply the amount on line 5 by 10%	0.00
7. Enter the total of the withheld social security and Medicare taxes	0.00
8. One-half of self-employment tax, plus FICA tax on tips and uncollected social security, Medicare or RRTA taxes	0.00
9. Total of line 7 and line 8	0.00
10. Earned income credit and excess social security & RRTA taxes withheld	0.00
11. Subtract line 10 from line 9. (If zero or less, enter 0.)	0.00
12. Larger of line 6 or line 11	0.00
13. Additional Child Tax Credit	0.00

Name Of Taxpayer:	J Winston & Sheri S Krause	04/26/2006
Identification Number:	[REDACTED]	Total 6,20.00

2002 - PERSONAL EXEMPTION WORKSHEET

1. Multiply \$ 3,000.00 by the total number of exemptions claimed on Form 1040, line 6e	15,000.00
2. Adjusted Gross Income	498,456.00
3. Limitation based on Filing Status	206,000.00
4. Subtract line 3 from line 2	292,456.00
5. Divide line 4 by \$2,500 (\$1,250 if married filing separate)	0.00
6. Multiply line 5 by 2% and enter the result as a decimal	0.00
7. Multiply line 1 by line 6	0.00
8. Deduction for exemptions (Subtract line 7 from line 1)	0.00

Note: If Line 4 is more than \$122,500. or (\$61,250. if married filing separately), a deduction for exemptions cannot be taken.

Name Of Taxpayer: J Winston & Sheri S Krause
 Identification Number: [REDACTED]

07/03/2006
 7.20.00

Total

2002 TAX YEAR INTEREST COMPUTATION

Interest computed to	08/02/2006
Total Tax Deficiency	\$155,439.00
Plus Penalties*	
Failure to File / Failure to Pay - IRC 6651	\$.00
Estimated Tax Penalty - IRC 6654	\$.00
Accuracy Related Penalty - IRC 6662	\$.00
Accuracy Related Penalty - IRC 6662A	\$.00
Civil Fraud - IRC 6663	\$.00
Manually Computed Penalty	\$62,175.60
Total Penalties	<u>\$62,175.60</u>
Tax Deficiency and Penalties Subject to Interest	<u>\$217,614.60</u>

Type	Effective Dates	Days	Rate	Interest
Compound	04/15/2003--09/30/2003	168	5%	\$3,618.46
Compound	10/01/2003--12/31/2003	92	4%	\$2,138.52
Compound	01/01/2004--03/31/2004	91	4%	\$2,232.47
Compound	04/01/2004--06/30/2004	91	5%	\$2,821.95
Compound	07/01/2004--09/30/2004	92	4%	\$2,308.20
Compound	10/01/2004--12/31/2004	92	5%	\$2,918.04
Compound	01/01/2005--03/31/2005	90	5%	\$2,898.27
Compound	04/01/2005--09/30/2005	183	6%	\$7,223.47
Compound	10/01/2005--12/31/2005	92	7%	\$4,338.86
Compound	01/01/2006--03/31/2006	90	7%	\$4,319.25
Compound	04/01/2006--08/02/2006	124	8%	\$6,953.93

Total Interest	\$41,771.42
Total Underpayment	\$155,439.00
Total Penalties	<u>\$62,175.60</u>
Total Amount Due	\$259,386.02

Interest on penalties is computed from the due date of the return (including extensions) until the date of payment.

Name Of Taxpayer: J Winston & Sheri S Krause
Identification Number: [REDACTED]

Total

04/26/2006
6.20.00

2002 - SCHEDULE A - ITEMIZED DEDUCTIONS

	PER RETURN	PER EXAM	ADJUSTMENT
1. Medical, dental and insurance premiums	2,124.00	2,124.00	0.00
2. 7.50% of Adjusted Gross Income	0.00	37,384.00	
3. Net Medical and Dental Expense	2,124.00	0.00	2,124.00
4. Taxes	19,884.00	19,884.00	0.00
5. Home Interest Expense	44,598.00	44,598.00	0.00
6. Investment Interest	0.00	0.00	0.00
7. Other Interest Expense	0.00	0.00	0.00
8. Total Interest Expense	44,598.00	44,598.00	0.00
9. Contributions	0.00	38,224.00	(38,224.00)
10. Casualty and theft Losses	0.00	0.00	0.00
11. Miscellaneous deductions subject to AGI limit	1,109.00	1,109.00	0.00
12. 2.00% of Adjusted Gross Income	0.00	9,969.00	
13. Excess Miscellaneous deductions	1,109.00	0.00	1,109.00
14. Other Miscellaneous deductions	0.00	0.00	0.00
15. Total itemized deductions (Sum of Lines 3, 4, 8, 9, 10, 13, and 14 less any applicable limitation)	67,715.00	91,871.00	(24,156.00)

ITEMIZED DEDUCTIONS WORKSHEET - PER EXAM

A. Total of lines 3, 4, 8, 9, 10, 13, and 14	102,706.00
B. Total of lines 3, 6, 10, (plus any gambling losses included on line 14)	0.00
C. Line A less Line B	102,706.00
D. Multiply the amount on line C by 80%	82,165.00
E. Adjusted Gross Income from Form 1040	498,456.00
F. Itemized Deduction Limitation	137,300.00
G. Line E less Line F	361,156.00
H. Multiply the amount on Line G by 3%	10,835.00
I. Enter the smaller of Line D or Line H	10,835.00
J. Total Itemized Deductions (entered on line 15 above)	91,871.00

PL0016

Name of Taxpayer: J Winston & Sheri S Krause 04/26/2006
 Identification Number: [REDACTED] Total 6.20.00

2002 - SCHEDULE D - CAPITAL GAINS AND LOSSES

1. Short-term capital gain or loss	0.00
2. Short-term capital loss carryover	0.00
3. Net Short-term Gain or Loss (Add line 1 and 2)	0.00
4. Long-term capital gain or loss	90.00
5. Long-term capital gain or loss carryover	0.00
6. Net long-term Gain or Loss (Add line 4 and 5)	90.00
7. Sum of lines 3 and 6 - Net Capital Gain or Loss	90.00
8. Capital loss limitation	0.00
9. Capital Gain or Loss - As Corrected	90.00
10. Capital Gain or Loss - Per Return	90.00
11. Line 9 less line 10 - Adjustment to Income	0.00
CORRECTED CARRYOVER	
12. Short-term Carryover to Subsequent Year	0.00
13. Long-term Carryover to Subsequent Year	0.00
COMPUTATION OF ALTERNATIVE TAX	
14. Unrecaptured 1250 gain	0.00
15. Taxable Income	406,585.00
16. Smaller of line 6 or line 7	90.00
17. Form 4952, line 4e	0.00
18. Subtract line 17 from line 16 (not less than 0)	90.00
19. Subtract line 18 from line 15 (not less than 0)	406,495.00
20. Tax on the amount on line 19	127,666.00
21. Smaller of line 15 or 46,700.00	46,700.00
22. Amount from line 19	406,495.00
23. Subtract line 22 from line 21 (not less than 0)	0.00
24. Qualified 5-year gain	0.00
25. Smaller of line 23 or line 24	0.00
26. Multiply line 25 by 8%	0.00
27. Subtract line 25 from line 23	0.00
28. Multiply line 27 by 10%	0.00
29. Smaller of line 15 or line 18	90.00
30. Amount from line 23	0.00
31. Subtract line 30 from line 29 (not less than 0)	90.00
32. Multiply line 31 by 20%	18.00
33. Alternative Tax, sum of lines 20, 26, 28, and 32	127,684.00

PL0017

Name of Taxpayer	J Winston & Sheri S Krause	04/26/2006
Identification Number:	[REDACTED]	Total 6.20.00

2003 - Form 6251 - Alternative Minimum Tax Computation

1. If filing Schedule A enter tax table income, otherwise adjusted gross income	291,974.00
2. Total adjustment and preferences	16,482.00
3. Net operating loss deduction	0.00
4. Alternative tax net operating loss deduction	0.00
5. Alternative minimum taxable income (combine lines 1 thru 4)	308,456.00
6. Exemption amount	18,386.00
7. Subtract line 6 from line 5 (if 0 or less, enter 0)	290,070.00
8. If capital gains are reported, see line 30 from page 2	77,654.00
All others:	
If line 7 is \$175,000 or less (\$87,500 if MFS) multiply line 7 by 26%. Otherwise, multiply line 7 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	
9. Alternative minimum tax foreign tax credit	0.00
10. Tentative minimum tax. Subtract line 9 from line 8	77,654.00
11. Regular tax before credits	77,702.00
12. Alternative minimum tax	0.00

Exemption Worksheet (Line 6)

A. Exemption amount based on filing status	58,000.00
B. Alternative minimum taxable income	308,456.00
C. Enter \$112,500 (\$150,000 if married filing jointly or qualifying widow(er), \$75,000 if married filing separate)	150,000.00
D. Subtract line C from Line B	158,456.00
E. Multiply line D by 25%	39,614.00
F. Subtract line E from line A (if zero or less, enter 0)	18,386.00

Name of Taxpayer:	J Winston & Sheri S Krause	04/26/2006
Identification Number:	XXXXXXXXXX	Total 6.20.00

2003 - Form 6251 - Continuation, Tax Computation Using Maximum Capital Gain Rates

1. Amount from Form 6251 report, line 7	290,070.00
2. Amount from Schedule D line 26, or line 13 from worksheet (refigured for AMT)	511.00
3. Amount from Schedule D line 19 (refigured for AMT)	0.00
4. Amount from line 2 if no Schedule D worksheet otherwise, the smaller of the sum of 2 or 3 or Schedule D worksheet line 10	511.00
5. Smaller of line 1 or line 4	511.00
6. Subtract line 5 from line 1	289,559.00
7. If line 6 is \$175,000 or less (\$87,500 if MFS) multiply line 6 by 26%. Otherwise, multiply line 6 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	77,577.00
8. Amount from Schedule D line 30, or line 19 from worksheet (refigured for AMT)	0.00
9. Smallest of line 1 or line 2	511.00
10. Smallest of line 8 or line 9 (not less than zero)	0.00
11. Amount from Schedule D line 43 (line 31 if line 43 is blank) or line 32 (line 20 if line 32 is blank) from the worksheet (refigured for AMT)	511.00
12. Smaller of line 10 or line 11 (not less than zero)	0.00
13. Multiply line 12 by 5%	0.00
14. Subtract line 12 from line 10	0.00
15. Qualified 5-year gain from Schedule D line 35 (refigured for AMT)	0.00
16. Smaller of line 14 or line 15	0.00
17. Multiply line 16 by 8%	0.00
18. Subtract line 16 from line 14	0.00
19. Multiply line 18 by 10%	0.00
20. Subtract line 12 from line 11	511.00
21. Subtract line 10 from line 9	511.00
22. Smaller of line 20 or line 21	511.00
23. Multiply line 22 by 15%	77.00
24. Subtract line 22 from line 21	0.00
25. Multiply line 24 by 20%	0.00
26. Subtract line 9 from line 5	0.00
27. Multiply line 26 by 25%	0.00
28. Total of lines 7, 13, 17, 19, 23, 25, and 27	77,654.00
29. If line 1 is \$175,000 or less (\$87,500 if MFS) multiply line 1 by 26%. Otherwise, multiply line 1 by 28% and subtract \$3,500 (\$1,750 if MFS) from result	77,720.00
30. Smaller of line 28 or 29, enter here and on line 8 of Form 6251 report	77,654.00

Name Of Taxpayer:	J Winston & Sheri S Krause	04/26/2006
Identification Number:	[REDACTED]	Total 6.20.00

2003 - PERSONAL EXEMPTION WORKSHEET

1. Multiply \$ 3,050.00 by the total number of exemptions claimed on Form 1040, line 6e	15,250.00
2. Adjusted Gross Income	401,669.00
3. Limitation based on Filing Status	209,250.00
4. Subtract line 3 from line 2	192,419.00
5. Divide line 4 by \$2,500 (\$1,250 if married filing separate)	0.00
6. Multiply line 5 by 2% and enter the result as a decimal	0.00
7. Multiply line 1 by line 6	0.00
8. Deduction for exemptions (Subtract line 7 from line 1)	0.00

Note: If Line 4 is more than \$122,500. or (\$61,250. if married filing separately), a deduction for exemptions cannot be taken.

Name Of Taxpayer: J Winston & Sheri S Krause

07/03/2006

Identification Number: [REDACTED] Total

7,200.00

2003 TAX YEAR INTEREST COMPUTATION

Interest computed to	08/02/2006
Total Tax Deficiency	\$27,443.00
Plus Penalties*	
Failure to File / Failure to Pay - IRC 6651	\$.00
Estimated Tax Penalty - IRC 6654	\$.00
Accuracy Related Penalty - IRC 6662	\$.00
Accuracy Related Penalty - IRC 6662A	\$.00
Civil Fraud - IRC 6663	\$.00
Manually Computed Penalty	\$31,082.00
Total Penalties	\$31,082.00
Tax Deficiency and Penalties Subject to Interest	\$58,525.00

Type	Effective Dates	Days	Rate	Interest
Compound	04/15/2004--06/30/2004	76	5%	\$286.39
Compound	07/01/2004--09/30/2004	92	4%	\$280.20
Compound	10/01/2004--12/31/2004	92	5%	\$682.89
Compound	01/01/2005--03/31/2005	90	5%	\$741.46
Compound	04/01/2005--06/30/2005	91	6%	\$911.98
Compound	07/01/2005--09/30/2005	92	6%	\$935.97
Compound	10/01/2005--12/31/2005	92	7%	\$1,110.00
Compound	01/01/2006--03/31/2006	90	7%	\$1,104.98
Compound	04/01/2006--06/30/2006	91	8%	\$1,300.83
Compound	07/01/2006--08/02/2006	33	8%	\$478.17

Total Interest	\$7,832.87
Total Underpayment	\$27,443.00
Total Penalties	\$31,082.00
Total Amount Due	\$66,357.87

Interest on penalties is computed from the due date of the return (including extensions) until the date of payment.

Name Of Taxpayer: J Winston & Sheri S Krause
Identification Number: [REDACTED]

Total

04/26/2006
6,20.00

2003 - SCHEDULE A - ITEMIZED DEDUCTIONS

	PER RETURN	PER EXAM	ADJUSTMENT
1. Medical, dental and insurance premiums	3,875.00	3,875.00	0.00
2. 7.50% of Adjusted Gross Income	30,125.00	30,125.00	
3. Net Medical and Dental Expense	0.00	0.00	0.00
4. Taxes	24,347.00	24,347.00	0.00
5. Home Interest Expense	29,358.00	29,358.00	0.00
6. Investment Interest	76.00	76.00	0.00
7. Other Interest Expense	0.00	0.00	0.00
8. Total Interest Expense	29,434.00	29,434.00	0.00
9. Contributions	146,942.00	63,779.00	83,163.00
10. Casualty and theft Losses	0.00	0.00	0.00
11. Miscellaneous deductions subject to AGI limit	227.00	227.00	0.00
12. 2.00% of Adjusted Gross Income	8,033.00	8,033.00	
13. Excess Miscellaneous deductions	0.00	0.00	0.00
14. Other Miscellaneous deductions	0.00	0.00	0.00
15. Total itemized deductions (Sum of Lines 3, 4, 8, 9, 10, 13, and 14 less any applicable limitation)	192,858.00	109,695.00	83,163.00

ITEMIZED DEDUCTIONS WORKSHEET - PER EXAM

A. Total of lines 3, 4, 8, 9, 10, 13, and 14	117,560.00
B. Total of lines 3, 6, 10, (plus any gambling losses included on line 14)	76.00
C. Line A less Line B	117,484.00
D. Multiply the amount on line C by 80%	93,987.00
E. Adjusted Gross Income from Form 1040	401,669.00
F. Itemized Deduction Limitation	139,500.00
G. Line E less Line F	262,169.00
H. Multiply the amount on Line G by 3%	7,865.00
I. Enter the smaller of Line D or Line H	7,865.00
J. Total Itemized Deductions (entered on line 15 above)	109,695.00

PL0022

Name of Taxpayer: J Winston & Sheri S Krause
 Identification Number: [REDACTED]

Total

04/26/2006
 6.20.00

2003 - SCHEDULE D - CAPITAL GAINS AND LOSSES

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

1	Short-term capital gain or loss	(18,271.00)
2	Short-term capital loss carryover	0.00
3	Short Post-May 5 gain or (loss)	(25,125.00)
4	Net Short-term Gain or Loss (Add line 1 and 2)	(18,271.00)

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

5	Long-term capital gain or loss	(17,389.00)
6	Long-term capital gain or loss carryover	0.00
7	Long Post-May 5 gain or (loss)	0.00
8	Net long-term Gain or Loss (Add line 5 and 6)	(17,389.00)

Part III Taxable Gain or Deductible Loss

9	Sum of lines 4 and 8 - Net Capital Gain or Loss	(35,660.00)
10	Sum of lines 3 and 7	0.00
11	Capital loss limitation	(3,000.00)
12	Capital Gain or Loss - As Corrected	(3,000.00)
13	Capital Gain or Loss - Per Return	(3,000.00)
14	Line 12 less line 13 - Adjustment to Income	0.00

CORRECTED CARRYOVER

15	Short-term Carryover to Subsequent Year	(15,271.00)
16	Long-term Carryover to Subsequent Year	(17,389.00)

Name of Taxpayer: J Winston & Sheri S Krause
 Identification Number: [REDACTED]

Total

04/26/2006
 6,200.00

Part IV Tax Computation Using Maximum Capital Gains Rates

17	Enter your taxable income from Form 1040, line 40	17	291,974.00
18	Enter the smaller of line 8 or line 9, but not less than zero	18	0.00
19	Enter your qualified dividends from Form 1040, line 9b	19	511.00
20	Add lines 18 and 19	20	511.00
21	Amount from line 4g of Form 4952 (investment interest expense)	21	0.00
22	Subtract line 21 from line 20. If zero or less, enter -0-	22	511.00
23	Subtract line 22 from line 17. If zero or less, enter -0-	23	291,463.00
24	Enter the smaller of line 17 or: 56,800.00 • \$56,800 if married filing jointly or qualifying widow(er); • \$28,400 if single or married filing separately; or • \$38,050 if head of household If line 23 is more than line 24, skip lines 30-35 and go to line 36.	24	56,800.00
25	Enter the amount from line 23	25	
26	Subtract line 25 from line 24. If zero or less, go to line 36	26	
27	Add lines 10 and 19	27	
28	Enter the smaller of line 26 or line 27	28	
29	Multiply line 28 by 5% (.05)	29	
	If lines 26 and 28 are the same, skip lines 30-35 and go to line 36.		
30	Subtract line 28 from line 26	30	
31	Enter your qualified 5-year gain	31	
32	Enter the smaller of line 30 or line 31	32	
33	Multiply line 32 by 8% (.08)	33	
34	Subtract line 32 from line 30	34	
35	Multiply line 34 by 10% (.10)	35	
	If lines 22 and 26 are the same, skip lines 36-45 and go to line 46.		
36	Enter the smaller of line 17 or line 22	36	511.00
37	Enter the amount from line 26 (if line 26 is blank, enter -0-)	37	0.00
38	Subtract line 37 from line 36	38	511.00
39	Add lines 10 and 19	39	511.00
40	Enter the amount from line 28 (if line 28 is blank, enter -0-)	40	0.00
41	Subtract line 40 from line 39	41	511.00
42	Enter the smaller of line 38 or line 41	42	511.00
43	Multiply line 42 by 15% (.15)	43	76.65
44	Subtract line 42 from line 38	44	0.00
45	Multiply line 44 by 20% (.20)	45	0.00
46	Figure the tax on the amount on line 23. Use the Tax Table or Tax Rate Schedules, whichever applies	46	77,628.00
47	Add lines 29, 33, 35, 43, 45, and 46	47	77,704.65
48	Figure the tax on the amount on line 17. Use the Tax Table or Tax Rate Schedules, whichever applies	48	77,797.00
49	Tax on all taxable income. Enter the smaller of line 47 or line 48 here and on Form 1040, line 41	49	77,704.65

Worksheet for Lines 27 and 39

1.	Enter your qualified dividends from Form 1040, line 9b	1.	511.00
2.	Enter the amount from Form 4952, line 4g	2.	0.00
3.	Enter the amount from Form 4952, line 4e	3.	0.00
4.	Subtract line 3 from line 2. If zero or less, enter -0-	4.	0.00
5.	Subtract line 4 from line 1. If zero or less, enter -0-	5.	511.00
6.	Enter the amount from Schedule D, line 10	6.	0.00
7.	Add lines 5 and 6. Enter the result here and on Schedule D, lines 27 and 39 (unless you are skipping the line)	7.	511.00

Krause, J Winston & Sheri
2002
Self-Employment Recompurations

Per Returns:
Other Self-Employment Income to 1040s
Schedule C Net Income
Schedule E Net Income - Krause & Associates LC
Schedule E Net Income - Boulevard Oaks
Schedule E Net Income - Interfase Capital Mgrs LLC
Schedule E Net Income - Krause & Associates Advanced Strategies LP
variance

	J Winston	Sheri	Total
	0	0	0
	(1,192,655)	(1,184,624)	(2,377,279)
	(4,043)	(4,016)	(8,059)
	0	0	0
	0	0	0
	(1)	(0)	(1)
	(1,196,699)	(1,188,640)	(2,385,339)
	50.169%	49.831%	(2,385,339)

Per Exam:
Per Returns:
Other Self-Employment Income to 1040s
Schedule C Net Income
Schedule E Net Income - Krause & Associates LP
Schedule E Net Income - Boulevard Oaks
Schedule E Net Income - Interfase Capital Mgrs LLC
Schedule E Net Income - Krause & Associates Advanced Strategies LP
variance

	J Winston	Sheri	Total
	0	0	0
	206,582	205,191	411,773
	(4,043)	(4,016)	(8,059)
	0	0	0
	0	0	0
	0	0	0
	202,539	201,175	403,714
	50.169%	49.831%	403,714

Adjustment to Self-Employment Income:

	1,399,238	1,389,915	2,789,053
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Schedule SE:
Net SE Income
multiplied by .9235
multiplied by .029 for med tax

	202,539	201,175	403,714
	187,045	185,785	372,830
	5,424	5,388	10,812

Max subject to SE tax
Wages with FICA Withheld
W-2 from Settlement Club
NET Max subject to SE tax
multiplied by .124

	80,400	80,400	
	80,400	38,681	
	9,970	41,719	
		5,173	
			15,143

Total SE TAX
Deduction for 1/2 of SE tax

	15,394	10,561	25,955
	(7,697)	(5,280)	(12,977)
			25,955
			(12,977)

Form **6251**
 Department of the Treasury
 Internal Revenue Service (99)

Alternative Minimum Tax—Individuals

OMB No. 1545-0227

2003

Attachment
 Sequence No. **32**

▶ See separate instructions.

▶ Attach to Form 1040 or Form 1040NR.

Name(s) shown on Form 1040

Your social security number

Krause

Part I Alternative Minimum Taxable Income (See instructions for how to complete each line.)

1	If filing Schedule A (Form 1040), enter the amount from Form 1040, line 38, and go to line 2. Otherwise, enter the amount from Form 1040, line 35, and go to line 7. (If zero or less, enter as a negative amount.)	1	-1,936,209
2	Medical and dental. Enter the smaller of Schedule A (Form 1040), line 4, or 2 1/2% of Form 1040, line 35.	2	3,875
3	Taxes from Schedule A (Form 1040), line 9.	3	24,347
4	Certain interest on a home mortgage not used to buy, build, or improve your home.	4	
5	Miscellaneous deductions from Schedule A (Form 1040), line 26.	5	227
6	If Form 1040, line 35, is over \$139,500 (over \$69,750 if married filing separately), enter the amount from line 9 of the worksheet for Schedule A (Form 1040), line 28.	6	()
7	Tax refund from Form 1040, line 10 or line 21.	7	()
8	Investment interest expense (difference between regular tax and AMT)	8	
9	Depletion (difference between regular tax and AMT)	9	
10	Net operating loss deduction from Form 1040, line 21. Enter as a positive amount.	10	2,279,995
11	Interest from specified private activity bonds exempt from the regular tax.	11	
12	Qualified small business stock (see instructions)	12	
13	Exercise of incentive stock options (excess of AMT income over regular tax income)	13	
14	Estates and trusts (amount from Schedule K-1 (Form 1041), line 9)	14	
15	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	15	
16	Disposition of property (difference between AMT and regular tax gain or loss)	16	
17	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT).	17	
18	Passive activities (difference between AMT and regular tax income or loss)	18	
19	Loss limitations (difference between AMT and regular tax income or loss)	19	
20	Circulation costs (difference between regular tax and AMT)	20	
21	Long-term contracts (difference between AMT and regular tax income)	21	
22	Mining costs (difference between regular tax and AMT)	22	
23	Research and experimental costs (difference between regular tax and AMT)	23	
24	Income from certain installment sales before January 1, 1987.	24	()
25	Intangible drilling costs preference	25	
26	Other adjustments, including income-based related adjustments	26	
27	Alternative tax net operating loss deduction	27	(335,012)
28	Alternative minimum taxable income. Combine lines 1 through 27. (If married filing separately and line 28 is more than \$191,000, see page 7 of the instructions.)	28	37,224

Part II Alternative Minimum Tax

29	Exemption. (If this form is for a child under age 14, see page 7 of the instructions.)														
	<table border="0"> <tr> <td>IF your filing status is . . .</td> <td>AND line 28 is not over . . .</td> <td>THEN enter on line 29 . . .</td> </tr> <tr> <td>Single or head of household</td> <td>\$112,500</td> <td>\$40,250</td> </tr> <tr> <td>Married filing jointly or qualifying widow(er)</td> <td>150,000</td> <td>58,000</td> </tr> <tr> <td>Married filing separately</td> <td>75,000</td> <td>29,000</td> </tr> </table>	IF your filing status is . . .	AND line 28 is not over . . .	THEN enter on line 29 . . .	Single or head of household	\$112,500	\$40,250	Married filing jointly or qualifying widow(er)	150,000	58,000	Married filing separately	75,000	29,000	29	58,000
IF your filing status is . . .	AND line 28 is not over . . .	THEN enter on line 29 . . .													
Single or head of household	\$112,500	\$40,250													
Married filing jointly or qualifying widow(er)	150,000	58,000													
Married filing separately	75,000	29,000													
30	If line 28 is over the amount shown above for your filing status, see page 7 of the instructions. Subtract line 29 from line 28. If zero or less, enter -0- here and on lines 33 and 35 and stop here.	30	0												
31	<ul style="list-style-type: none"> • If you reported capital gain distributions directly on Form 1040, line 13a; you reported qualified dividends on Form 1040, line 9b; or you had a gain on both lines 16 and 17a of Schedule D (Form 1040) (as refigured for the AMT, if necessary), complete Part III on the back and enter the amount from line 65 here. • All others: If line 30 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 30 by 26% (.26). Otherwise, multiply line 30 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result. 	31													
32	Alternative minimum tax foreign tax credit (see page 7 of the instructions)	32													
33	Tentative minimum tax. Subtract line 32 from line 31.	33													
34	Tax from Form 1040, line 41 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 44).	34													
35	Alternative minimum tax. Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 42.	35	0												

For Paperwork Reduction Act Notice, see page 8 of the instructions.

Cat. No. 13600G

Form **6251** (2003)

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399	Years/Periods Ended 30-200212, 30 -200312	

1. The deduction of \$2,791,250 shown on your 2002 tax return, 1040 Form 4797, as a loss for from the termination of options is disallowed because you have failed to establish (1) that the purported loss was sustained in any amount by either you or any entity in which you held an interest, (2) that the transaction purportedly generating the loss in question was entered into for profit within the meaning of I.R.C. Section 165(c) (2), or (3) that any portion of the loss in question is allowable as a deduction under any other provision of the Internal Revenue Code. You have also failed to establish that, even if loss was sustained and would otherwise be deductible, any deduction relating to the loss is not specifically limited or disallowed by any provision of the Internal Revenue Code, including without limitation §§165, 183, 212, 704(d), or 465.

2. It is further determined that to the extent the loss in question is attributable to an investment in offsetting options, such amount is disallowed because the transactions were entered into for purposes of tax avoidance. The transactions giving rise to the loss, including the sale of paired foreign currency options by its purported partner J Winston Krause in exchange for debt instruments, the termination of some options while still held by J Winston Krause and his subsequent transfer of other options to Krause & Associates Advanced Strategies LP in return for a partnership interest, and the transfer of partnership interests in Krause & Associates Advanced Strategies LP among its partners, had no business purpose other than tax avoidance,, had no business purpose other than tax avoidance, lacked economic substance, and, in fact and substance, constitutes an economic sham for federal income tax purposes. As such, any loss incurred in connection with the transactions in question are not deductible.

3. It is further determined that the loss of \$2,791,250 claimed for tax year 2002 is disallowed because you have failed to establish that the basis in the terminated options and foreign currency sold was greater than \$0 for purposes of determining the amount of the purported loss under §165(b), and that the basis in the partnership interest held by J Winston Krause and by Krause & Associates LP in purported partnership, Krause & Associates Advanced Strategies LP, was greater than zero.

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399		Years/Periods Ended 30-200212, 302-200312

4. It is further determined that neither you, Krause & Associates Advanced Strategies LP nor its purported partners entered into the option positions with a profit motive for purposes of §165(c)(2).
5. As a consequence of the above determinations, no gain was recognized on the termination of the short option contributed to Krause & Associates Advanced Strategies LP, and therefore the partners are not entitled to any increase in tax basis in their partnership interests as a result of such gain for purposes of IRC §704.
6. It is further determined, in the alternative, that the obligations under the short position transferred to Krause & Associates Advanced Strategies LP constitute liabilities for purposes of Treasury Regulation §1.752-6, the assumption of which by Krause & Associates Advanced Strategies LP shall reduce the purported partners' bases in Krause & Associates Advanced Strategies LP in the amounts of \$2,791,250 for partner J. Winston Krause, but not below the fair market value of the purported partnership interest.
7. It is further determined that you have failed to establish your basis in debt instruments or other property contributed to Krause & Associates Advanced Strategies LP under any provision of the Internal Revenue Code, including but not limited to I.R.C. §1012, §723 and/or §722. It is consequently determined that you Krause & Associates Advanced Strategies LP have not established your adjusted basis in your direct and indirect partnership interests in an amount greater than zero (-0-).
8. In the alternative, it is further determined that the purported termination of the short option (loss leg) retained by J Winston Krause, followed by the purported termination of the short option contributed to Krause & Associates Advanced Strategies LP (gain leg), lacked economic substance and did not constitute sales or exchanges for federal income tax purposes. No gain or loss was realized on the purported termination of the legs in question and the partnership's adjusted basis in the purportedly terminated legs is decreased to reflect the non-recognition of the gain.

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399	Years/Periods Ended 30-200212, 302-200312	

9. It is further determined that the written option claimed to have been contributed to Krause & Associates Advanced Strategies LP and the written option claimed to have been retained by you (the option pair) are in substance a single integrated financial transaction. Pursuant to §1.988-2(f) of the Income Tax Regulations, the option pair is hereby recharacterized as a single integrated financial transaction to correspond with its substance. Accordingly, your purported basis in Krause & Associates Advanced Strategies LP that was derived from gain associated with the option purportedly transferred to Krause & Associates Advanced Strategies LP is disallowed.
10. It is further determined that any section 988 loss claimed on the sale of foreign currency that is not due to changes in exchange rates has no economic substance under section 1.988-2(f) and is not recognized for federal income tax purposes.
11. It is further determined, in the alternative, that the loss deduction of \$2,791,250 claimed on your 2002 federal income tax return should be decreased to \$0 to limit any loss incurred by you and the partnership in connection with the option transaction to the amount actually at risk in the transaction, pursuant to Internal Revenue Code § 465(b)(4).
12. It is further determined that no deduction is allowed for any legal, accounting, consulting and advisory fees claimed since you failed to establish that such expenditures were incurred, and if incurred, are deductible under any provision of the Internal Revenue Code, including but not limited to Internal Revenue Code §§ 183 and 212.
13. NOL Carryovers: Your Net Operating Loss carryover from the 2002 tax year is decreased to the extent shown reflecting the statutory adjustment required by section 172 of the Internal Revenue Code and predicated upon your increased adjusted gross income per the adjustments above. Accordingly your NOL Deduction for the 2003 tax year is \$0.

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399		Years/Periods Ended 30-200212, 302-200312

14. **Charitable Contributions Carryovers:** Your claimed Charitable Contributions carryovers are decreased to the extent shown reflecting the statutory adjustment required by section 170(d) of the Internal Revenue Code and predicated upon your increased adjusted gross income per the adjustments above. Accordingly your Contributions Carryover to the 2002 tax year is decreased by \$44,939, your Contributions Carryover to the 2003 tax year is decreased by \$83,163, and your Charitable Contributions Deduction for the 2003 tax year is decreased by \$83,163.
15. **Charitable Contributions Allowable Deduction:** Your claimed Charitable Contributions deduction is increased to the extent shown reflecting the statutory adjustment required by section 170(b) of the Internal Revenue Code and predicated upon your increased adjusted gross income per the adjustments above. Accordingly your Contributions Deduction for the 2002 tax year is increased by \$38,224.
16. **Self Employment Tax:** Your liability for self-employment tax is increased to the extent shown reflecting the statutory adjustment required by section 1402 of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustments above. Accordingly your Self-Employment Tax for the 2002 tax year is increased by \$25,955.
17. **Deduction for 1/2 of Self Employment Tax:** Your deduction for one-half of self-employment tax is increased to the extent shown reflecting the statutory adjustment required by section 164(f) of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustments above. Accordingly your Self-Employment Tax Deduction for the 2002 tax year is increased by \$12,978.
18. **Itemized Deductions - Medical Expenses:** Your claimed deductions for medical expenses are disallowed to the extent shown reflecting the statutory adjustment required by section 213(a) of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustment above. Accordingly your Medical Expense deduction for the 2002 tax year is decreased by \$2,124.

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399		Years/Periods Ended 30-200212, 302-200312

19. **Miscellaneous Expenses:** Your claimed deductions for miscellaneous expenses are disallowed to the extent shown reflecting the statutory adjustment required by section 67 of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustment above. Accordingly your Miscellaneous Expense deduction for the 2002 tax year is decreased by \$1,109.
20. **Itemized Deductions:** Your claimed deductions for itemized deductions is disallowed to the extent shown reflecting the statutory adjustment required by section 68 of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustment above. Accordingly your Itemized Deductions for the 2002 tax year is decreased by \$24,156.
21. **Exemptions:** The amount you can claim for your exemptions is reduced to the extent shown reflecting the statutory adjustment required by section 151 of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustments above. Accordingly your taxable income for the 2002 tax year is increased by \$15,000.
22. **Additional Child Tax Credit:** Your additional child tax is decreased to the extent shown reflecting the statutory adjustment required by section 24 of the Internal Revenue Code and predicated upon your increased adjusted gross income per adjustments above. Accordingly your Additional Child Tax Credit for the 2002 tax year is decreased by \$1,800.
23. **Penalties:**

It is determined that the underpayments of tax for the taxable years ended December 31, 2002 and December 31, 2003 are attributable to a tax shelter for which you have not established substantial authority for the position taken, and you have not shown that you had a reasonable belief upon the filing of your return that the position taken was more likely than not the correct treatment of the tax shelter and related transactions. It is also determined that, at a minimum, you are liable for the accuracy-related penalty imposed under § 6662(a) of the Internal Revenue Code for the tax year ended December 31, 2002 and December 31, 2003 because the underpayment of tax is attributable to (1) a substantial understatement

Form 886A	Department of the Treasury - Internal Revenue Service Statutory Notice of Deficiency Explanation of Items	Schedule No. or Exhibit SNOD - 200212, 200312
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399		Years/Periods Ended 30-200212, 302-200312

of income tax, (2) valuation misstatement(s), and (3) negligence or disregarded rules or regulations. You have not shown there was reasonable cause for the underpayment, that you acted in good faith, or that any other exceptions to the penalty apply. The penalty is imposed on the components of underpayment as follows:

- A. a 40 percent penalty is imposed on the underpayment attributable to the gross valuation misstatement of the adjusted basis in your loss option transaction. Sections 6662(a), 6662(b)(3), 6662(e) and 6662(h) of the Internal Revenue Code.
- B. a 20 percent penalty is imposed on the portion of the underpayment attributable to negligence or disregard of rules and regulations as provided by §§ 6662(a), 6662(b)(1), 6662(c) of the Internal Revenue Code.
- C. a 20 percent penalty is imposed on the underpayment attributable to the substantial understatement of income tax as provided by §§ 6662(a), 6662(b)(2), and 6662(d) of the Internal Revenue Code.
- D. a 20 percent penalty is imposed on the underpayment attributable to the substantial valuation misstatement as provided by §§ 6662(a), 6662(b)(3), and 6662(e) of the Internal Revenue Code.

It should not be inferred by the determination of the Accuracy-Related Penalty in this notice that fraud penalties will not be sought on any portion of an underpayment subsequently determined to be attributable to fraud or that prosecution for criminal offenses will not be sought under Internal Revenue Code §§ 7201, 7206 or other provisions of federal law if determined to be appropriate.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit 6 page 1
Explanation of Items		
Name of Taxpayer Krause, J Winston & Sheri S P.O. Box 5399 Austin, TX 78763-5399		Year/Period Ended 12-31-2002, 12-31-2003

Accuracy-Related Penalties, IRC 6662

	Penalty: IRC 6662(a)	Penalty: IRC 6662(h)	Total Penalty: IRC 6662
2002			
Per Return:	0.	0.00	0.00
Per Examination	0.	62,175.60	62,175.60
Penalty	0.	62,175.60	62,175.60
2003			
Per Return:	0.	0.00	0.00
Per Examination			
from audit of 1040X	0.	10,977.20	10,977.20
addition related to NOLD			
from original 1040		20,104.80	20,104.80
Total Penalty	0.	31,082.00	31,082.00