

Part II Organizational Action (continued)

17 List the applicable Internal Revenue Code section(s) and subsection(s) upon which the tax treatment is based ▶ Please see attached.

Multiple horizontal lines for providing details for question 17.

18 Can any resulting loss be recognized? ▶ Please see attached.

Multiple horizontal lines for providing details for question 18.

19 Provide any other information necessary to implement the adjustment, such as the reportable tax year ▶ Please see attached, as amended on April 12, 2018.

Multiple horizontal lines for providing details for question 19.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

Sign Here

Signature ▶ Scott Kingsley Date ▶ 4/12/18
Print your name ▶ Scott Kingsley Title ▶ EVP and CFO

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶	Firm's EIN ▶			
	Firm's address ▶	Phone no.			

Form 8937

Community Bank System, Inc. (NYSE: CBU)

Posted on Community Bank System, Inc.'s website on March 16, 2017

Updated and posted on Community Bank System, Inc.'s website on April 12, 2018 following the release of the escrowed consideration (see page 8 for new subsection No. 4 to Question 16 entitled "Additional Consideration")

EIN: 16-1213679

The information contained herein is being provided pursuant to the requirements of Section 6045B of the Internal Revenue Code of 1986, as amended (the "Code"). It contains a general summary regarding the application of certain U.S. federal income tax laws and regulations relating to the effects of the Merger (as defined below) on the tax basis of the various forms of merger consideration received by former Northeast Retirement Services, Inc. ("NRS") stockholders in connection with the Merger.

Community Bank System, Inc. (NYSE: CBU; "Community Bank System") does not provide tax advice to its stockholders. The examples below are provided pursuant to Section 6045B of the Code and are illustrative in nature for the convenience of the former stockholders of NRS and their tax advisors to use in connection with establishing their specific tax position. You should consult your own tax advisor regarding the particular consequences of the Merger to you, including the applicability and effect of all U.S. federal, state and local and foreign tax laws.

THE INFORMATION CONTAINED HEREIN DOES NOT CONSTITUTE TAX ADVICE AND DOES NOT PURPORT TO BE COMPLETE OR TO DESCRIBE THE CONSEQUENCES THAT MAY APPLY TO PARTICULAR CATEGORIES OF STOCKHOLDERS, NOR IS IT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSES OF AVOIDING PENALTIES UNDER THE CODE OR PROMOTING, MARKETING OR RECOMMENDING ANY TRANSACTION OR MATTER ADDRESSED HEREIN.

Part II

Question 14

On February 3, 2017, Community Bank System completed its acquisition of NRS pursuant to the Agreement and Plan of Merger, dated as of December 2, 2016 (the "Merger Agreement"), by and between Community Bank System, NRS, Cohiba Merger Sub, LLC ("Merger Sub"), and Shareholder Representative Services LLC. Under the terms of the Merger Agreement, NRS merged with and into Merger Sub (the "Merger"), with Merger Sub being the surviving corporation of the Merger.

Under the terms of the Merger Agreement, NRS stockholders were entitled to elect the form of merger consideration to be received in the transaction. Each stockholder who submitted a completed Letter of Election and Transmittal prior to the election deadline of February 1, 2017 had the ability to elect to receive, for each share of NRS common stock either (a) \$1,105.83 in cash, (b) 20.9081 shares of Community Bank System common stock, par value \$1.00 per share, or (c) the combination of \$552.92 in cash and 10.4541 shares of Community Bank System common stock. In addition, at the closing of the Merger, Community Bank System deposited into escrow, to satisfy certain customary indemnification obligations of NRS stockholders, an amount per NRS share equal to 1.1628 shares of Community Bank System common stock and \$61.50 in cash and paid to the Stockholders' Representative, on behalf of the NRS stockholders, an amount equal to \$1.17 in cash per NRS share, to pay the Stockholders' Representative's fees and expenses. However, all elections were subject to certain adjustment and allocation procedures set forth in the Merger Agreement to ensure that approximately 50% of the NRS common stock was converted into cash and approximately 50% of NRS common stock was converted into shares of Community Bank System common stock.

Most of the NRS stockholders who submitted election forms by the election deadline made either the "mixed election" or the "all-stock" election to receive their merger consideration partially or solely in the form of shares of Community Bank System common stock. As a result of the elections of NRS stockholders, and in accordance with the allocation and proration mechanisms of the Merger Agreement, the merger consideration was allocated as follows:

- Those stockholders who elected to receive only Community Bank System common stock in the Merger received, for each share of NRS common stock they owned, received \$319.04 of cash per share and 14.8760 shares of Community Bank Common Stock;
- Those stockholders who elected to receive all cash in the Merger received \$1,105.83 in cash for each share of NRS common stock they owned;
- Those stockholders who elected to receive 50% in Community Bank System common stock and 50% in cash received \$552.92 in cash and 10.4541 shares of Community Bank System, Inc. common stock per share; and
- Those stockholders that did not select an election preference or submit a properly completed election form within the required timeframe received 50% in Community Bank System common stock and 50% in cash received \$552.92 in cash and 10.4541 shares of Community Bank System, Inc. common stock per share.

No fractional shares of Community Bank System common stock were issued in the Merger and any fractional share of Community Bank System common stock was paid at the rate of \$59.09 per share.

Additional Consideration

In addition to the Merger consideration paid at the closing on February 3, 2017, Community Bank System deposited into escrow, to satisfy certain customary indemnification obligations of NRS stockholders, an amount per NRS share equal to 1.1628 shares of Community Bank System common stock and \$61.50 in cash. The indemnification escrow was structured to survive until the later of the 12 month anniversary date of the closing (February 3, 2018) or the date Community Bank System files its Form 10-K for the year ending December 31, 2017. On or about March 1, 2018, the escrow consideration was released from escrow (without any reduction) to the former NRS stockholders based upon the contribution of each to the escrow fund. The escrow agent will issue each stockholder a Form 1099 reflecting the amount of escrowed consideration paid to such stockholder in 2018.

Question 15

The effect of the Merger on the tax basis of an NRS stockholder depends on the form of consideration received and are summarized below:

1. **Stockholders who received only cash consideration** (i.e., NRS stockholders who elected cash only consideration).

A transaction in which a stockholder exchanged his or her shares of NRS common stock solely for cash generally will result in recognition of gain or loss by the holder in an amount equal to the difference between the amount of cash received in the Merger and the stockholder's tax basis in the NRS shares surrendered. Because the stockholder did not receive any new stock, there will be no new basis to compute. The taxability of capital gains and/or deductibility of capital losses is subject to limitations. *You should consult your tax advisor for more information.*

2. **Stockholders who received mixed merger consideration consisting of both stock and cash** (i.e., NRS stockholders who elected to receive (1) a combination of 50% stock and 50% cash consideration, (2) those who made an invalid election or no election or (3) all stock consideration and were subject to proration).

A transaction in which a stockholder exchanged his or her shares of NRS common stock for a combination of Community Bank System common stock and cash affects such stockholder's tax basis. Generally, the aggregate tax basis of Community Bank System common stock received by the NRS stockholder in the Merger will be equal to the aggregate adjusted tax basis of the shares of NRS common stock exchanged, reduced by the amount of cash received pursuant to the Merger (excluding any cash received in lieu of a fractional share of Community Bank System common stock) and increased by the amount of gain (excluding gain or loss resulting from any fractional share deemed received and exchanged for cash), if any, recognized by the NRS stockholder on the exchange. The amount of gain recognized is the lesser of (A) the amount of gain realized (i.e., the excess of the sum of the amount of cash and the fair market value of

Community Bank System common stock received pursuant to the Merger over the stockholder's aggregate tax basis in the shares of NRS common stock surrendered) and (B) the amount of cash received pursuant to the Merger (excluding any cash received in lieu of a fractional share of Community Bank System common stock).

Treatment of Cash in Lieu of Fractional Shares. The receipt of cash in lieu of a fractional share of Community Bank System common stock generally will be treated as if the fractional share had been distributed to the NRS stockholder in connection with the Merger and then sold for cash in a taxable transaction. Gain or loss generally will be recognized based on the difference between the amount of cash received in lieu of the fractional share and the portion of the stockholder's aggregate adjusted tax basis in the shares of Community Bank System common stock received in the Merger that is allocable to the fractional share. The gain or loss generally will be long-term capital gain or loss if the holding period of the corresponding NRS common stock surrendered is more than one year at the effective time of the Merger. The deductibility of capital losses is subject to limitations.

Fair Market Value of the Stock Received. U.S. federal income tax law does not specifically prescribe how you should determine the fair market value of Community Bank System common stock for purposes of allocating your tax basis in connection with the Merger. Generally, fair market value is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the facts. One possible approach to the various methods for determining the fair market value of Community Bank System common stock is to use the closing price of Community Bank System's common stock on February 3, 2017, the day of Merger, which was \$59.35 per share as reported on the New York Stock Exchange. Other approaches to determine the fair market value may also be possible. *You should consult your tax advisor to determine what measure of fair market value is appropriate.*

Question 16

The following example illustrates the method by which a former NRS stockholder would determine his or her basis in the Community Bank System stock received in the Merger. The example assumes that the stockholder is an individual U.S. citizen or resident who acquired his or her NRS stock in one block at the same price for cash and holds such shares as capital assets. The example does not address any special rules that may apply to a particular stockholder (including shares received as compensation), nor do they address the consequences of any state, local or foreign tax laws.

1. Stockholders receiving only cash consideration

The following is an illustrative example of how the basis determination would be applied to a hypothetical stockholder who received cash consideration:

Shares of NRS common stock owned: 100

Assumed tax basis in each share of NRS common stock: \$100.00 per share

NRS stockholder's aggregate adjusted tax basis (100 shares of NRS common stock multiplied by \$100.00 per share): \$10,000.00

Cash consideration received in the Merger (100 shares of NRS common stock multiplied by \$1,107 in cash per share, which includes \$1.17 per share paid to SRS): \$110,700.00

Recognized gain (\$110,700 in cash consideration received minus \$10,000.00 aggregate adjusted tax basis): \$100,700.00

2. Stockholders receiving mixed 50% stock and 50% cash consideration

The following is an illustrative example of the basis determination for a hypothetical stockholder who elected to receive 50% stock consideration and 50% cash consideration:

Shares of NRS common stock owned: 100

Assumed tax basis in each share of NRS common stock: \$100.00 per share

Fair market value of each share of Community Bank System common stock received in the Merger: \$59.35 (closing price of Community Bank System's common stock on February 3, 2017, the day of the Merger)

No fractional shares of Community Bank System common stock were issued in the Merger and any fractional share of Community Bank System common stock was paid at the rate of \$59.09 per share.

1. **Cost basis in NRS Common Stock:** \$10,000.00

(100 shares of NRS common stock multiplied by \$100.00 per share)

2. **Total Merger Consideration:**

Common stock received in Merger (1,045 shares of Community Bank System common stock multiplied by \$59.35) \$62,020.75

Number of shares determined as follows:

Each share of NRS common stock was exchanged for 10.4541 shares of Community Bank System common stock (10.4541 multiplied by 100 shares):
1,045.41 shares

Whole shares of Community Bank System common stock received in the Merger: 1,045 (rounded down from 1,045.41)

Cash consideration received in the Merger (100 shares of NRS common stock multiplied by \$552.92 in cash per share) + 55,292.00

	Cash consideration paid to SRS (100 shares of NRS common stock multiplied by \$1.17 in cash per share)	+ 117.00
	Value of fractional share of Community Bank System share received (0.41 shares of Community Bank System common stock multiplied by \$59.09 in cash per share)	+ 24.23
	Total Merger Consideration	<hr/> \$117,453.98
3.	Realized Gain	
	Total Consideration	\$117,453.98
	Less: Cost basis in NRS common stock	<hr/> -10,000.00
	Realized Gain:	\$107,453.98
4.	Recognized Gain	\$55,409.00
	Determined as lesser of Realized Gain or Cash Received (not including cash in lieu of the fractional shares)	
5.	Tax Basis in Community Bank System shares received in the Merger	
	Basis in NRS Shares	\$10,000.00
	Less: Cash Amount Received	-55,409.00
	Plus: Recognized Gain	<hr/> +55,409.00
	Basis in Community Bank System shares	\$10,000.00
6.	Taxable Gain on Fractional Share	
	Cash paid in lieu of fraction shares (.41 multiplied by \$59.09)	\$24.23
	Less: Basis attributable to fractional shares (.41 multiplied by \$9.57)	-3.92
	<u>Basis of fractional share determined as follows:</u> <i>Total basis in Community Bank System stock divided by the amount of Community Bank System shares received, including fractional shares (\$10,000/1,045.41): \$9.57</i>	
	Taxable Gain	<hr/> \$20.31
7.	Final Adjusted Tax Basis in Community Bank System Shares	
	Basis in shares received (including fractional shares)	\$10,000.00
	Less: Basis attributable to fractional share	<hr/> - 3.92
	Basis in Community Bank System shares	\$9,996.08
	Per Share Basis (\$9,996.08 divided by 1,045)	\$9.57

3. Stockholders receiving mixed stock and cash consideration who elected to receive all stock consideration but were subject to proration

The following is an illustrative example of the basis determination for a hypothetical stockholder who elected to receive all stock consideration and was subject to proration.

Shares of NRS common stock owned: 100

Assumed tax basis in each share of NRS common stock: \$100.00 per share

Fair market value of each share of Community Bank System common stock received in the Merger: \$59.35 (closing price of Community Bank System's common stock on February 3, 2017, the day of the Merger)

No fractional shares of Community Bank System common stock were issued in the Merger and any fractional share of Community Bank System common stock was paid at the rate of \$59.09 per share.

1.	Cost basis in NRS Common Stock:	\$10,000.00
	(100 shares of NRS common stock multiplied by \$100.00 per share)	
2.	Total Merger Consideration:	
	Common stock received in Merger (1,487 Shares of Community Bank System common stock multiplied by \$59.35)	\$88,253.45
	<u>Number of shares determined as follows:</u> <i>Each share of NRS common stock was exchanged for 14.8760 shares of Community Bank System common stock (14.8760 multiplied by 100 shares): 1,487.6 shares</i>	
	<i>Whole shares of Community Bank System common stock received in the Merger (1,487.6 shares, rounded down to the nearest whole share): 1,487 (rounded down from 1,487.6)</i>	
	Cash consideration received in the Merger (Each share of NRS common stock multiplied by \$319.04 in cash per share)	+31,904.00
	Cash consideration paid to SRS (100 shares of NRS common stock multiplied by \$1.17 in cash per share)	+ 117.00
	Value of fractional share of Community Bank System shares received (.60 shares of Community Bank System common stock multiplied by \$59.09 in cash per share)	+ 35.45
	Total Merger Consideration	<hr/> \$120,309.90

3.	Realized Gain		
	Total Consideration		\$120,309.90
	Less: Cost basis in NRS common stock		-10,000.00
	Realized Gain:		\$110,309.90
4.	Recognized Gain		\$32,021.00
	Determined as lesser of Realized Gain or Cash Received (not including cash in lieu of the fractional shares)		
5.	Tax Basis in Community Bank System shares received in the Merger		
	Basis in NRS Shares		\$10,000.00
	Less: Cash Amount Received		-32,021.00
	Plus: Recognized Gain		+32,021.00
	Basis in Community Bank System shares		\$10,000.00
6.	Taxable Gain on Fractional Share		
	Cash paid in lieu of fraction shares (.60 multiplied by \$59.09)		\$35.45
	Less: Basis attributable to fractional shares (.60 multiplied by \$6.72)		-4.03
	<u>Basis of fractional share determined as follows:</u>		
	<i>Total basis in Community Bank System stock divided by the amount of Community Bank System shares received, including fractional shares \$10,000/1,487.6): \$6.72</i>		
	Taxable Gain		\$31.42
7.	Final Adjusted Tax Basis in Community Bank System Shares		
	Basis in shares received (including fractional shares)		\$10,000.00
	Less: Basis attributable to fractional share		-4.03
	Basis in Community Bank System shares		\$9,995.97
	Per Share Basis (\$9,995.97 divided by 1,487)		\$6.72

4. Additional Consideration

The following is an illustrative example of the basis determination for a hypothetical stockholder who received the additional consideration on March 1, 2018:

Shares of NRS common stock owned and exchanged in 2017: 100

Assumed tax basis in each share of NRS common stock: \$0.00 per share (All shares exchanged in 2017)

Fair market value of each share of Community Bank System common stock received in the Merger: \$59.35 (closing price of Community Bank System's common stock on February 3, 2017, the day of the Merger)

1. **Total Additional Merger Consideration:**

Escrowed common stock received in Merger (116.28 shares of Community Bank System common stock multiplied by \$59.35)	\$6,901.22
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Number of shares determined as follows:

Pursuant to the Merger Agreement, each share of NRS common stock was exchanged and held in escrow for 1.1628 shares of Community Bank System common stock (1.1628 multiplied by 100 shares): 116.28 shares

Escrowed cash consideration received in the Merger (100 shares of NRS common stock multiplied by \$61.50 in cash per share)	+ 6,150.00
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Total Escrowed Merger Consideration	\$13,051.22
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2. **Realized Gain**

Total Additional Consideration	\$13,051.22
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Less: Cost basis in NRS common stock	- 0
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Realized Gain:	\$13,051.22
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3. **Recognized Gain**

Determined as lesser of Realized Gain or Cash Received	\$6,150.00
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4. **Tax Basis in Community Bank System shares received in the Merger**

Basis in NRS Shares	\$ 0
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Less: Cash Amount Received	-6,150.00
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Plus: Recognized Gain	+6,150.00
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Basis in Community Bank System shares	\$ 0
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Questions 17 & 18

The Merger was intended to qualify as a “reorganization” within the meaning of Section 368(a) of the Code. In general, the federal income tax consequences to the former NRS stockholders are determined under Sections 356, 358 and 1221 of the Code. Generally, NRS stockholders must recognize gain (but not loss), pursuant to Section 356 of the Code, in an amount equal to the lesser of (1) the amount of gain realized (i.e., the excess of the sum of the amount of cash and fair market value of the Community Bank System common stock received in the Merger over the stockholder’s adjusted basis in its shares of NRS common stock surrendered, as determined pursuant to Sections 1001 and 1011 of the Code) and (2) the amount of cash received pursuant to

the Merger (excluding any cash received in lieu of a fractional share of Community Bank System common stock).

Question 19

The Merger and initial consideration payment was effective February 3, 2017 and the reportable tax year for the initial consideration is 2017. The additional escrowed consideration which was distributed on or about March 1, 2018 is to be reported in tax year 2018.