

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.

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

19 Provide any other information necessary to implement the adjustment, such as the reportable tax year ▶ The Merger and resulting stock exchange was effective on December 4, 2015. For Oneida Financial stockholders whose taxable year is the calendar year, the reportable tax year is 2015.

Sign Here

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.

Signature ▶ *Scott Kingsley* Date ▶ January 15, 2016
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 January 15, 2016

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 Oneida Financial Corp. (NASDAQ: ONFC; "Oneida Financial") 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 Oneida Financial 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. You also are urged to read the Registration Statement of Community Bank System filed with the Securities and Exchange Commission on Form S-4, dated March 30, 2015 (Registration No. 333-203102) (the "Registration Statement"), as amended, noting especially the discussion under "Material U.S. Federal Income Tax Consequences of the Merger."

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 December 4, 2015, Community Bank System completed its acquisition of Oneida Financial pursuant to the Agreement and Plan of Merger, dated as of February 24, 2015 (the "Merger Agreement"), by and between Community Bank System and Oneida Financial. Under the terms of the Merger Agreement, Oneida Financial merged with and into Community Bank System (the "Merger"), with Community Bank System being the surviving corporation of the Merger.

Under the terms of the Merger Agreement, Oneida Financial 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 November 25, 2015 had the ability to elect to receive, for each share of Oneida Financial common stock either (a) cash at the rate of \$20.00 per share, (b) 0.5635 shares of Community Bank System common stock, or (c) a combination of 60% Community Bank System common stock and 40% cash, using the same 0.5635 exchange ratio and \$20.00 per share cash price. However, all elections were subject to certain allocation procedures set forth in the Merger Agreement to ensure that 60% of the aggregate merger consideration was in the form of shares of Community Bank System common stock and 40% was in the form of cash.

Most of the Oneida Financial stockholders who submitted election forms by the election deadline made the “all-stock” election to receive their merger consideration solely in the form of shares of Community Bank System common stock. As a result of the elections of Oneida Financial 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 Oneida Financial common stock they owned, 72.03061% of their merger consideration in shares of Community Bank System common stock (at an exchange ratio of 0.5635 per share and rounded to the nearest whole share) and the balance in cash at a rate of \$20.00 for each whole share of Oneida Financial common stock;
- Those stockholders who elected to receive all cash in the Merger received \$20.00 in cash for each share of Oneida Financial common stock they owned;
- Those stockholders who elected to receive 60% in Community Bank System common stock and 40% in cash received 60% in stock and 40% in cash, using the same 0.5635 exchange ratio and \$20.00 per share cash price; and
- Those stockholders that did not select an election preference or submit a properly completed election form within the required timeframe received \$20.00 in cash for each of their shares of Oneida Financial common stock.

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 \$20.00 per share.

Question 15

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

1. **Stockholders who received only cash consideration** (i.e., Oneida Financial stockholders who elected cash only consideration or those who made an invalid election or no election).

A transaction in which a stockholder exchanged his or her shares of Oneida Financial 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 Oneida Financial 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., Oneida Financial stockholders who elected to receive (1) a combination of 60% stock and 40% cash consideration or (2) all stock consideration and were subject to proration).

A transaction in which a stockholder exchanged his or her shares of Oneida Financial 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 Oneida Financial stockholder in the Merger will be equal to the aggregate adjusted tax basis of the shares of Oneida Financial 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 Oneida Financial 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 Oneida Financial 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 Oneida Financial 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 Oneida Financial

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 December 4, 2015, the day of Merger, which was \$42.99 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 Oneida Financial 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 Oneida Financial 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 Oneida Financial common stock owned: 100

Assumed tax basis in each share of Oneida Financial common stock: \$5.00 per share

Oneida Financial stockholder's aggregate adjusted tax basis (100 shares of Oneida Financial common stock multiplied by \$5.00 per share): \$500.00

Cash consideration received in the Merger (100 shares of Oneida Financial common stock multiplied by \$20.00 in cash per share): \$2,000.00

Recognized gain (\$2,000 in cash consideration received minus \$500.00 aggregate adjusted tax basis): \$1,500.00

2. Stockholders receiving mixed 60% stock and 40% cash consideration

The following is an illustrative example of the basis determination for a hypothetical stockholder who elected to receive 60% stock consideration and 40% cash consideration:

Shares of Oneida Financial common stock owned: 100

Assumed tax basis in each share of Oneida Financial common stock: \$5.00 per share

Fair market value of each share of Community Bank System common stock received in the Merger: \$42.99 (closing price of Community Bank System's common stock on December 4, 2015, 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 \$20.00 per share.

1.	Cost basis in Oneida Financial Common Stock:	\$500.00
	(100 shares of Oneida Financial common stock multiplied by \$5.00 per share)	
2.	Total Merger Consideration:	
	Common stock received in Merger (33 shares of Community Bank System common stock multiplied by \$42.99)	\$1,418.67
	<u>Number of shares determined as follows:</u> <i>Shares of Oneida Financial common stock exchanged for 60% stock consideration (60% of 100 shares): 60</i>	
	<i>Whole shares of Community Bank System common stock received in the Merger (60 shares of Oneida Financial common stock multiplied by the exchange ratio of 0.5635, rounded down to the nearest whole share): 33 (rounded down from 33.81)</i>	
	Cash consideration received in the Merger (40 shares of Oneida Financial common stock multiplied by \$20.00 in cash per share)	+ 800.00
	<u>Number of shares determined as follows:</u> <i>Shares of Oneida Financial common stock exchanged for 40% cash consideration (40% of 100 shares): 40</i>	
	Value of fractional share of Community Bank System share received (.81 shares of Community Bank System common stock multiplied by \$20.00 in cash per share)	+ 16.20
	Total Merger Consideration	<hr/> \$2,234.87

3.	Realized Gain		
	Total Consideration		\$2,234.87
	Less: Cost basis in Oneida Financial common stock		- 500.00
	Realized Gain:		\$1,734.87
4.	Recognized Gain		\$800.00
	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 Oneida Financial Shares		\$500.00
	Less: Cash Amount Received		-800.00
	Plus: Recognized Gain		+800.00
	Basis in Community Bank System shares		\$500.00
6.	Taxable Gain on Fractional Share		
	Cash paid in lieu of fraction shares (.81 multiplied by \$20.00)		\$16.20
	Less: Basis attributable to fractional shares (.81 multiplied by \$14.79)		-11.98
	<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 (\$500/33.81): \$14.79</i>		
	Taxable Gain		\$4.22
7.	Final Adjusted Tax Basis in Community Bank System Shares		
	Basis in shares received (including fractional shares)		\$500.00
	Less: Basis attributable to fractional share		- 11.98
	Basis in Community Bank System shares		\$488.02
	Per Share Basis (\$488.02 divided by 33)		\$14.79

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 Oneida Financial common stock owned: 100

Assumed tax basis in each share of Oneida Financial common stock: \$5.00 per share

Fair market value of each share of Community Bank System common stock received in the Merger: \$42.99 (closing price of Community Bank System's common stock on December 4, 2015, 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 \$20.00 per share.

1.	Cost basis in Oneida Financial Common Stock:	\$500.00
	(100 shares of Oneida Financial common stock multiplied by \$5.00 per share)	
2.	Total Merger Consideration:	
	Common stock received in Merger (40 Shares of Community Bank System common stock multiplied by \$42.99)	\$1,719.60
	<i>Number of shares determined as follows:</i>	
	<i>Shares of Oneida Financial common stock exchanged for 72.03061% stock consideration (72.03061% of 100 shares): 72.03061</i>	
	<i>Whole shares of Community Bank System common stock received in the Merger (72.03061 shares of Oneida Financial common stock multiplied by the exchange ratio of 0.5635, rounded down to the nearest whole share): 40 (rounded down from 40.5892)</i>	
	Cash consideration received in the Merger (27.96939 shares of Oneida Financial common stock multiplied by \$20.00 in cash per share)	+ 559.39
	<i>Number of shares determined as follows:</i>	
	<i>Shares of Oneida Financial common stock exchanged for 27.96939% cash consideration (27.96939% of 100 shares): 27.96939</i>	
	Value of fractional share of Community Bank System shares received (.5892 shares of Community Bank System common stock multiplied by \$20.00 in cash per share)	+ 11.78
	Total Merger Consideration	\$2,290.77
3.	Realized Gain	
	Total Consideration	\$2,290.77
	Less: Cost basis in Oneida Financial common stock	- 500.00
	Realized Gain:	\$1,790.77
4.	Recognized Gain	\$559.39
	<i>Determined as lesser of Realized Gain or Cash Received (not including cash in lieu of the fractional shares)</i>	

5. **Tax Basis in Community Bank System shares received in the Merger**

Basis in Oneida Financial Shares	\$500.00
Less: Cash Amount Received	-559.39
Plus: Recognized Gain	+559.39
Basis in Community Bank System shares	\$500.00

6. **Taxable Gain on Fractional Share**

Cash paid in lieu of fraction shares (.5892 multiplied by \$20.00)	\$11.78
Less: Basis attributable to fractional shares (.5892 multiplied by \$12.32)	-7.26

Basis of fractional share determined as follows:

Total basis in Community Bank System stock divided by the amount of Community Bank System shares received, including fractional shares (\$500/40.5892): \$12.32

Taxable Gain	\$4.52
---------------------	---------------

7. **Final Adjusted Tax Basis in Community Bank System Shares**

Basis in shares received (including fractional shares)	\$500.00
Less: Basis attributable to fractional share	-7.26
Basis in Community Bank System shares	\$492.74
Per Share Basis (\$482.74 divided by 40)	\$12.32

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 Oneida Financial stockholders are determined under Sections 356, 358 and 1221 of the Code. Generally, Oneida Financial 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 Oneida Financial 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).