

Part II Organizational Action (continued)

17 List the applicable Internal Revenue Code section(s) and subsection(s) upon which the tax treatment is based ▶
Internal Revenue Code Sections 354, 356, 358, 368(a), 1001 and 1221

18 Can any resulting loss be recognized? ▶ **Refer to the attached description of the basis calculation in Part II, Box 15 Above.**

19 Provide any other information necessary to implement the adjustment, such as the reportable tax year ▶
The transaction was consummated on December 11, 2015. The reportable tax year of the FNB shareholders for reporting the tax effect of the share exchange is the tax year that includes the December 11, 2015 date. For shareholders who report taxable income on the calendar year basis, 2015 is the taxable year.

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 ▶ *Mickey L. Jones* Date ▶ 1/22/16

Print your name ▶ **Mickey L. Jones** Title ▶ **COO / 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.	

Citizens Financial Services, Inc.
23-2265045
Attachment to Form 8937

REPORT OF ORGANIZATIONAL ACTIONS AFFECTING BASIS OF SECURITIES

Form 8937 Part I, Box 9:

The securities subject to reporting include all shares of Citizens Financial Services, Inc. (“Citizens”) common stock issued in exchange for the outstanding common stock of The First National Bank of Fredericksburg (“FNB”) as a result of the merger which closed December 11, 2015.

Form 8937 Part II, Box 14:

On December 11, 2015 Citizens, the holding company for First Citizens Community Bank (FCCB”), completed its acquisition of FNB with and into FCCB (the “Merger”), with FCCB as the surviving bank.

As a result of the Merger, FNB shareholders exchanged their common stock into a right to receive either 12.6000 shares of Citizens common stock, \$630.00 in cash, or a combination of cash and common stock of Citizens, subject to proration and allocation to ensure that 75% of the total number of shares of FNB common stock being exchanged for Citizens common stock and 25% exchanged for cash. To the extent that the exchange would have resulted in the issuance of a fractional share of Citizens common stock to an FNB shareholder, a cash payment equal to the market value equivalent of the fractional share was paid in lieu of issuing a fractional share of Citizens common stock.

Form 8937 Part II, Box 15:

The Merger of FNB with and into Citizens qualifies as a tax-free exchange within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended. As a result, each FNB shareholder’s tax consequences are as follows:

- FNB shareholders who receive solely cash in exchange for all of his or her FNB common stock as a result of the Merger will be treated as having received full payment for his or her FNB common stock. Consequently, since the shareholder did not receive any Citizens common stock, there will be no new basis to compute. Gain or loss will be recognized by those holders receiving solely cash for FNB common stock pursuant to the Merger equal to the difference in the amount of cash received by a holder of FNB common stock and such holder’s cost basis in such shares of FNB common stock. If the FNB common stock was held as a capital asset, any gain or loss will be a short-term or long-term capital gain or loss depending on the time the shareholder held the FNB common stock;
- No gain or loss will be recognized by those holders receiving solely shares of Citizens common stock in exchange for shares of FNB common stock pursuant to the Merger (except with respect to any cash received in lieu of fractional shares). The aggregate basis of the Citizens common stock received in the Merger will be the same as the aggregate basis of the FNB common stock for which it was exchanged (decreased by any cash received instead of fractional share interests in Citizens common stock);

- In general, a gain (but not loss) may be recognized by FNB shareholders who receive shares of Citizens common stock and cash in exchange for shares of FNB common stock pursuant to the Merger. Such shareholders will recognize gain, if any, equal to the lesser of (1) the amount of cash received or (2) the amount of gain “realized” in the transaction (i.e., the amount by which (i) the cash plus fair market value of the Citizens common stock received in the merger exceeds (ii) the shareholder’s basis in the FNB common stock surrendered in exchange for the cash and Citizens common stock. The aggregate basis of the Citizens common stock received in the Merger by a FNB shareholder who receives a combination of Citizens common stock and cash in exchange for his or her FNB common stock will be the same as the aggregate basis of the FNB common stock for which it was exchanged, decreased by the amount of cash received in the Merger (except with respect to any cash received instead of fractional share interests in Citizens common stock), decreased by any basis attributable to fractional share interests in Citizens common stock for which cash is received, and increased by the amount of gain recognized on the exchange, but excluding any gain or loss recognized with respect to fractional share interests in Citizens common stock for which cash is received;
- A holder of FNB common stock who receives cash instead of a fractional share of Citizens common stock will generally be treated as having received the fractional share pursuant to the Merger and then as having exchanged the fractional share for cash in a redemption by Citizens. As a result, a holder of FNB common stock will generally recognize a gain or loss equal to the difference between the amount of cash received and the basis in his or her fractional share interest as set forth above. The gain or loss will generally be a capital gain or loss, and will be a long-term capital gain or loss if, as of the effective date of the Merger, the holding period for such shares is greater than one year; and
- The holding period of Citizens common stock received in exchange for shares of FNB common stock will include the holding period of the FNB common stock for which it is exchanged.

If holders of FNB common stock acquired different blocks of FNB common stock at different times or at different prices, any gain or loss will be determined separately with respect to each block of FNB common stock and such holder’s basis and holding period in their shares of Citizens common stock may be determined with reference to each block of FNB common stock. Any such holders should consult their tax advisors regarding the manner in which cash and Citizens common stock received in the exchange should be allocated among different blocks of FNB common stock and with respect to identifying the bases or holding periods of the particular shares of Citizens stock received in the Merger.