

## Q&A for the XAI Octagon Floating Rate & Alternative Income Term Trust (“XFLT” or the “Trust”)

December 31, 2023

*The following information regarding investments in the XAI Octagon Floating Rate & Alternative Income Term Trust (XFLT) is provided for informational purposes only and is not intended as tax or investment advice. Neither XA Investments LLC nor the Trust offers tax advice. Before deciding to invest in the Trust’s shares, prospective investors are urged to consult their tax advisors. Investors should consider carefully the risks of investing and should review the Trust’s most recent annual report (and any more recent semi-annual report), which includes a description of principal risk factors.*

### Frequently asked questions (“FAQs”) about the Trust

- ☐ **Who serves as adviser, sub-adviser and portfolio manager for XFLT?**

XA Investments LLC (“XAI” or the “Adviser”) serves as the investment adviser to the Trust and is responsible for overseeing the Trust’s overall investment strategy and its implementation. Octagon Credit Investors, LLC serves as the investment sub-adviser for XFLT and is responsible for investing the Trust’s assets. Octagon has a 25+ year track record managing institutional client credit portfolios with approximately \$34.6 billion of assets under management (as of December 31, 2023).
- ☐ **Where are the Trust’s shares listed?**

XFLT common shares are listed on the New York Stock Exchange (“NYSE”) under the symbol “XFLT” and the Trust’s Series 2026 Preferred Shares are listed under the symbol “XFLT PRA”.
- ☐ **Where can I find XFLT’s Price and NAV Information?**

The Trust publishes a daily NAV. The common shares’ closing price and closing NAV at the end of each business day can be found on the Trust’s website at [www.xainvestments.com](http://www.xainvestments.com). XFLT’s intraday prices, daily closing price and NAV information can also be found on Bloomberg or other financial news service portals. In valuing the Trust’s investments in CLO debt and subordinated securities, the Trust generally uses non-binding indicative bid prices provided by an independent third-party pricing service (IHS Markit), and may consider a variety of relevant factors, including recent trading prices for specific investments, recent purchases and sales known to the Trust in similar securities, other information known to the Trust relating to the securities, and discounted cash flows based on output from a third-party financial model, using projected future cash flows.
- ☐ **Does XFLT have a Dividend Reinvestment Plan and how does it work?**

If you hold your common shares in your own name or if you hold your common shares with a brokerage firm that participates in the Trust’s Dividend Reinvestment Plan, unless you elect to receive cash, all dividends and distributions that are declared by the Trust will be automatically reinvested in additional common shares of the Trust pursuant to the Dividend Reinvestment Plan. If you hold your common shares with a brokerage firm that does not participate in the Dividend Reinvestment Plan, you will not be able to participate in the Dividend Reinvestment Plan and any

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dividend reinvestment may be affected on different terms than those applicable under the Dividend Reinvestment Plan. Consult your financial advisor for more information.

☐ **How do I find additional information about the Trust?**

The Trust regularly updates performance and certain other data and publishes material information as necessary from time to time on its website at [www.xainvestments.com](http://www.xainvestments.com). Investors are advised to review the Trust's current annual report (and any more recent semi-annual report), which includes a description of principal risk factors.

☐ **Does the Trust provide email alerts for additional information?**

To register for email alerts for press releases and publications, please go to the Trust's website at [www.xainvestments.com](http://www.xainvestments.com) and scroll to the bottom of the page.

## **Tax questions about the Trust**

☐ **How is the Trust structured for tax purposes?**

For U.S. federal income tax purposes, the Trust currently qualifies, and intends to remain qualified, as a registered investment company under the provisions of Subchapter M of the Internal Revenue Code of 1986, as amended, by distributing substantially all of its investment company taxable net income and realized gain, if any, to its shareholders and meeting the asset diversification and income requirements under the aforementioned provisions.

Generally, a registered investment company does not pay taxes but rather passes the tax liability from its investment operations through to its shareholders. A shareholder's tax liability is generally based upon the tax character of distributions paid by the registered investment company to the shareholder. The Trust issues a Form 1099-DIV to shareholders after the end of each tax year. The Form 1099-DIV will disclose the tax character of distributions paid by the Trust to each shareholder.

☐ **Who should I contact with questions on my Form 1099-DIV?**

The information on your Form 1099-DIV is reported by the Trust to your brokerage firm. Please contact your financial advisor, brokerage firm or tax advisor with questions.

☐ **What is the time period for the Trust's tax reporting to shareholders?**

The Trust has a September 30<sup>th</sup> tax year end. Amounts reported to shareholders on Form 1099-DIV for the calendar year will represent a combination of parts of two tax years: October 1, 2022 to December 31, 2022 and January 1, 2023 to September 30, 2023.

☐ **What were the Trust's distributions for the year-to-date calendar year ending December 31, 2022?**

During calendar year ending 2023, the Trust declared 12 regular, monthly distributions aggregating \$0.972 per common share. The Trust paid a monthly distribution of \$0.073 per common share from February 1, 2023 to May 1, 2023. The Trust then increase its distribution to \$0.085 per common share from June 1, 2023 to December 28, 2023. The Trust declared four dividends during the calendar year ending 2023 for its Series 2026 Preferred shares, totaling \$1.625 per share.

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The Trust's most recent common share distribution declared on December 1, 2023 represents an annualized distribution rate of 14.78% based on the Trust's closing market price of \$6.90 per common share on December 1, 2023.

☐ **What is the tax character of the Trust's cash distributions?**

The Trust makes cash distributions that are typically classified in one of three ways: (1) Dividend Income, (2) Long-Term Capital Gains and (3) Return of Capital.

Generally, a return of capital may represent either a distribution of earned income but for tax purposes has been deferred or it may represent a return of a shareholder's original investment. In the former case, the return of capital reflects positive performance of the Trust's portfolio and is beneficial. In the latter case, a shareholder should understand that such return has not been earned by the Trust and effectively that portion of the distributions represents a liquidation of the Trust's portfolio.

☐ **What is a tax return of capital?**

A tax return of capital may represent a distribution of earned income but for tax purposes has been deferred or it may represent a return of a shareholder's original investment. Tax earnings and profits are distinguishable from, and may differ from, earnings and profits computed under GAAP.

☐ **Explain differences in types of return of capital distributed by CEFs?**

During the tax year, CEFs estimate the sources of their distributions and, if necessary, report these estimates through Section 19(a) notices. Section 19(a) of the Investment Company Act of 1940, as amended, requires notice to shareholders if the payment of any distribution is made from any source other than a fund's net income. Section 19(a) notices are provided for informational purposes only and not for tax reporting purposes. At year-end, CEFs provide shareholders with final distribution classifications on Form 1099-DIV in order to enable shareholders to file their tax return correctly with the Internal Revenue Service.

XA Investments believes it is helpful to distinguish and clarify the differences between different types of returns of capital. Beneficial tax-deferred returns of capital may result from tax-deferred income generation or tax deferred realized gains in the portfolio that increase NAV. Such tax deferred returns of capital reduce an investor's cost basis and are only realized for tax purposes, when the shares are sold by the investor. Alternatively, returns of capital may result when a fund over-distributes, or pays cash distributions in excess of earnings. These returns of capital have the effect of eroding a fund's principal or NAV.

☐ **How are CLO equity holdings taxed?**

The Trust holds CLO equity securities, which are considered passive foreign investment company ("PFIC") securities for tax purposes. Registered funds must look through to the earnings of PFIC securities like CLO equity and pick up the Trust's proportionate share, regardless of the cash it has received from the PFIC security. This creates "phantom income" for tax purposes (income without receipt of cash).

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- **Explain how the Trust benefits from tax deferrals associated with its investments in CLO equity.**  
CLO equity is often treated as an interest in a PFIC for U.S. federal income tax purposes and the Trust generally includes its respective share of CLO equity income, gain, loss, and deduction on the last day of the CLO equity's tax year for U.S. federal income tax purposes. XFLT recognizes income from CLO equity in its taxable year that aligns with the CLO equity year end. The difference between the Trust's year end of September 30 and CLO equity year end (generally October 31 or December 31), allows XFLT to recognize this income on a lagged basis.
- **What are tax considerations for foreign shareholders?**  
Distributions of ordinary income dividends to foreign shareholders will generally be subject to withholding of U.S. federal tax at a 30% rate (or lower rate provided by an applicable treaty) to the extent of the Trust's current and accumulated earnings and profits for U.S. federal income tax purposes.

No U.S. source withholding taxes will be imposed on dividends paid by the Trust to foreign shareholders to the extent the dividends are designated as "interest related dividends" or "short term capital gain dividends." Under this exemption, interest related dividends and short-term capital gain dividends generally represent distributions of interest or short-term capital gain that would not have been subject to U.S. withholding tax at the source if they had been received directly by a foreign shareholder, and that satisfy certain other requirements.

## Excise Tax considerations for the Trust

- **What are the Trust's excise tax distribution requirements?**  
As a regulated investment company, the Trust is subject to a 4% excise tax if the Trust does not distribute by the end of any calendar year at least the sum of (i) 98% of its ordinary income (not taking into account any capital gain or loss) for the calendar year, (ii) 98.2% of its capital gain in excess of its capital loss (adjusted for certain ordinary losses) for a one-year period generally ending on October 31 of the calendar year and (iii) any distribution shortfall from the prior calendar year.

For XFLT's investments in CLO equity, Qualifying Electing Fund ("QEF")<sup>1</sup> income is recognized for excise tax purposes in accordance with the QEF's year end. XFLT recognizes its proportionate share of CLO tax earnings and profits—irrespective of the GAAP income that XFLT receives from such securities. As a result, XFLT includes current income in its distribution and is able to treat it as ordinary income or return capital (depending on the PFIC's income). While XFLT generally intends to distribute income and capital gains in the manner necessary to minimize (but not necessarily eliminate) the imposition of excise tax, it may retain income or capital gains and pay excise tax when it is determined that doing so is in the best interest of shareholders.

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<sup>1</sup> XFLT has elected Qualified Electing Fund ("QEF") treatment for each of its CLO Equity positions where the required information in order to do so is received by the Fund. In accordance with the QEF election, XFLT recognizes its proportionate share of CLO earnings for this purpose—irrespective of the GAAP income that XFLT receives from such securities.

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## Risk Considerations

Investing in CEFs involves risk; principal loss is possible. There is no guarantee the Trust's investment objective will be achieved. CEF shares may frequently trade at a discount to or premium to their net asset value. Senior Loans may not be fully secured by collateral, generally do not trade on exchanges, and are typically issued by unrated or below-investment grade companies, and therefore are subject to greater liquidity and credit risk. Lower credit debt securities may be more likely to fail to make timely interest or principal payments. Leverage increases return volatility and magnifies the Trust's potential return and its risks; there is no guarantee the Trust's leverage strategy will be successful. The Trust's shares are not guaranteed or endorsed by any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation ("FDIC"). **Performance data quoted represents past performance. Past performance does not guarantee of future results. Current performance may be higher or lower than the data shown.** An investment in the Trust presents a number of risks and is not suitable for all investors. Investors should carefully review and consider potential risks before investing. These and other risk considerations are described in more detail on the Trust's web page at [www.xainvestments.com](http://www.xainvestments.com).

**This material is not intended as a recommendation or as investment or tax guidance or advice of any kind.** This material is not provided in a fiduciary capacity, may not be relied upon for or in connection with the making of investment decisions, and does not constitute a solicitation of an offer to buy or sell securities. All content has been provided for informational or educational purposes only and is not intended to be and should not be construed as legal or tax advice and/or a legal opinion. **Always consult a financial, tax and/or legal professional regarding your specific situation.**

Distribution rates are not performance and are calculated by summing the quarterly distributions per share over four quarters and dividing by the NAV or market price, as applicable, as of the latest quarter end. Distributions may be comprised of ordinary income, net capital gains, and/or a return of capital (ROC) of your investment in the fund. To date, a portion of common stock distributions has been estimated to be a return of capital as noted under the Investor Relations section on the Trust's website. The actual components of the Trust's distributions for U.S. tax reporting purposes can only be finally determined as of the end of each fiscal year of the Trust and are thereafter reported on Form 1099-DIV. The Trust's distributions for fiscal year ended 2022 comprised 90.60% net income and 9.40% return of capital. The Trust's distributions for fiscal year ending 2023 will be made available and reported to investors subsequent to the end of fiscal year 2023. A distribution comprised in whole or in part by a return of capital does not necessarily reflect the company's investment performance and should not be confused with "yield" or "income." Future distributions may consist of a return of capital.

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