XAInvestments

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

December 19, 2018

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. XA Investments LLC does not offer 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 current annual report (and any more recent semi-annual report), which includes a description of principal risk factors.

Frequently asked questions ("FAQs") about the Trust

- **Where are XFLT common shares listed?**
  XFLT common shares are listed on the New York Stock Exchange ("NYSE").

- **What is the difference between a listed closed-end fund ("CEF") and an open-end fund?**
  Listed CEFs are exchange-listed and typically closed to new investments. Listed CEF shareholders can sell their shares on the exchange at the prevailing market price, which may be higher or lower than the fund's current net asset value. Open-end mutual funds are continuously offered and investors can redeem their shares daily at net asset value ("NAV").

- **Who serves as sub-adviser and portfolio manager for XFLT?**
  Octagon Credit Investors, LLC serves as the investment sub-adviser for XFLT and is responsible for portfolio management. Octagon has a 24-year track record managing institutional client credit portfolios with over $20 billion of assets under management (as of 9/30/18).

- **Where can I find XFLT's Price and NAV Information?**
  The Trust publishes a daily NAV. The Trust's closing price and closing NAV at the end of each business day can be found on the Trust's website at 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.

- **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 dividend reinvestment may be effected 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. Investors are advised to check the website for updated performance information and the release of other material information about the Trust.

- **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 at www.xainvestments.com and scroll to the bottom of the page.

- **Does XFLT pay regular distributions?**
  Yes, the Trust pays regular monthly distributions based on the Trust's earnings and net investment income. The Trust's distribution rate is not constant and the amount of distributions, when declared by the Trust's Board of Trustees, is subject to change (and may be increased or decreased) based on the current and projected performance of the Trust.

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, not offset by current capital losses (or loss carryforwards), if any, to its shareholders.

  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 amount of dividends and distributions of ordinary income and capital gains, if any, 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 amount of dividends and 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 broker. Please contact your financial advisor or tax advisor with questions.

- **What is the tax character of the Trust's investments?**
  The Trust invests primarily in floating-rate loans and structured credit investments, including collateralized loan obligations (CLOs), which are subject to federal, state and local income and capital gains taxation.

  Certain of the Trust's investment practices are subject to special and complex U.S. federal income tax provisions that may, among other things, (i) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (ii) convert lower taxed long-term capital gains or "qualified dividend income" into higher taxed short-term capital gains or ordinary income, (iii) convert an ordinary loss or a deduction into a capital loss (the deductibility of which is more limited), (iv) cause the Trust to recognize income or gain without a corresponding receipt of cash, (v) adversely affect the time as to when a purchase or sale of stock or securities is deemed to occur, (vi) adversely alter the characterization of certain complex financial transactions and (vii) produce income that will not be "qualified" income for purposes of the 90% gross income requirement. These U.S. federal income tax provisions could therefore affect the amount, timing and character of distributions to common shareholders. The Trust intends to structure and monitor its transactions and may make certain tax elections and may be required to dispose of securities to mitigate the effect of these provisions and prevent disqualification of the Trust as a regulated investment company.

- **What were the Trust's distributions for the calendar year ended 12/31/18?**
  During 2018, the Trust paid 12 regular, monthly distributions aggregating $0.828 per share.

- **What is the tax character of the Trust's cash distributions?**
  Funds make cash distributions that are typically classified in one of four ways: (1) Interest Income, (2) Short-Term Capital Gains, (3) Long-Term Capital Gains and (4) 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 fund and that effectively that portion of the distributions represents a liquidation of the Trust's portfolio. This important distinction is explained in further detail below.

- **What is the time period for the Trust's tax reporting to shareholders?**
  The Trust has a September 30th 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.
  - For 9/30/18 tax year end, we anticipate a positive return of capital representing the tax deferrals associated with CLO equity.
  - For the 12/31/18 Form 1099-DIV reporting period, XFLT's CLO equity earnings were deferred. XFLT shareholders benefit from a tax deferral on the income received with respect to the portion of the Trust's assets invested in CLO equity, which effectively pushes income forward into the next reporting period.

- **Explain how the Trust benefits from tax deferrals associated with its investments in CLO equity.**
  The Trust benefits from tax deferrals associated with its CLO equity investments. Throughout 2018, a portion of the Trust's assets consisted of investments in CLO equity.
  - **How does the tax deferral work?** CLO equity is often treated as an interest in a partnership for U.S. federal income tax purposes. Consistent with the CLO equity's classification as a partnership, 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. The Trust is permitted to follow income tax recognition for purposes of computing any excise tax if, among other requirements, the Trust does not hold partnership interests that represent 35% or more of its total assets on any testing date falling within the tax year. The Trust complies with the 35% requirement and is permitted to follow its income tax recognition, which helps avoid using estimates for Form 1099-DIV reporting and creates more certainty in respect of the cash distribution process.

The Trust's tax year end is September 30th, while CLO equity's tax year end is often December 31st. The Trust includes the CLO equity's items of income on the last day of the CLO equity's tax year (December 31st) for U.S. federal income tax purposes, notwithstanding that such items of income may have been earned prior to the close of the Trust's tax year on September 30th. Accordingly, due to the differences in the tax year end of the CLO equity and the tax year end of the Trust, the Trust is able to recognize income and gains on a deferred basis.

- **Quarterly Tax Monitoring:** Trust management monitors the Trust's portfolio on a quarterly basis to ensure that the Trust's maximum allocation of CLO equity complies with the 35% requirement discussed above.
- **What are XFLT shareholder benefits associated with the tax deferral?** Trust management is seeking to maximize tax benefits for XFLT shareholders by deferring taxes on CLO equity. The Trust uses Generally Accepted Accounting Principles ("GAAP") to record its earnings and set its monthly distributions. XAI management does extensive tax planning to defer taxable income and manage distributions to common shareholders. A tax deferral effectively pushes income forward into the next reporting period.

- **What is a tax return of capital?**
A distribution that is not based on the tax earnings and the profits of the Trust is a tax return of capital and represents a repayment of the shareholder's original investment in the Trust. 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?** Funds make cash distributions that are typically classified in one of four ways: (1) Interest Income, (2) Short-Term Capital Gains, (3) Long-Term Capital Gains and (4) Return of Capital. During the year, CEFs estimate the sources of their distributions and, if necessary, report these estimates through Section 19(a) notices. Section 19(a) notices are provided for informational purposes only and not for tax reporting purposes. At year-end, CEFs provide shareholders with final classifications in order to enable shareholders to file their tax return correctly with the Internal Revenue Service.

  We believe 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 in the fund's shares and are only realized for tax purposes, when the shares are sold by the investor. Alternatively, returns of capital may result when funds over-distribute, or pay cash distributions in excess of earnings. These returns of capital have the effect of eroding the fund's principal or NAV.

  1. If cash distributions equal or exceed GAAP earnings and GAAP earnings exceeds taxable income, the difference is considered a beneficial return of capital because of the tax deferral.

  2. If cash distributions exceed GAAP earnings, the excess is a return of capital that erodes NAV.

- **Why does the Trust have a tax return of capital in 2018?**
The Trust's current year distributions were based on GAAP earnings, and the taxable income recognized by the Trust for the year ending 9/30/18 was less than GAAP income predominantly

because of the Trust's investments in CLO equity. The difference between taxable income and GAAP income was the primary reason for the Trust's tax return of capital.

- **Was the Trust's return of capital for 2018 a beneficial tax-deferred return of capital?**
  Yes, the Trust had a beneficial return of capital for 2018 due to tax deferrals associated with its investments in CLO equity.

- **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.

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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"). **Past performance is no guarantee of future results.** 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.

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