

# The Premium Roth Conversion: A Self-Funding Strategy for Moving Qualified Assets Into Tax-Free Wealth

*How writing covered calls inside a Rollover IRA or self-directed 401(k) can systematically fund Roth conversions — without touching principal or outside savings.*

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For CPAs and estate planning attorneys working with clients who hold substantial qualified retirement accounts, the math of Required Minimum Distributions can be quietly alarming. A client who has diligently saved \$1 million or more in a traditional 401(k) or Rollover IRA hasn't actually saved that amount — not in after-tax terms. The IRS holds a silent ownership stake in every pre-tax dollar, and beginning at age 73, it starts calling in that interest through mandatory annual distributions, whether the client needs the income or not.

The result is a tax liability that compounds alongside the account balance, often arriving at the worst possible moment: when Social Security income, pension payments, and investment distributions are already pushing clients into higher brackets. For clients who inherited IRAs, the situation is more acute still — the SECURE Act's 10-year mandatory depletion rule compresses what was once a multi-decade tax deferral into a single decade, often stacking distributions directly on top of peak earning years.

The conventional response to these pressures is a Roth conversion: pay taxes now, at today's rates, and move assets into a permanently tax-free environment. The strategy is well understood in principle. What is less well understood — and what this article examines — is a specific structural approach, a different architecture that makes the conversion **largely self-funding**, by using income the qualified account can easily generate

***"The account generates the income that pays the tax bill. The conversion potentially costs the client nothing out of pocket."***

## The Problem With Standard Roth Conversions

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Traditional Roth conversion advice tells clients to pay the tax bill from outside savings — typically a taxable brokerage account or cash reserves. For many clients, this creates a meaningful psychological and financial barrier. Parting with \$40,000 to \$60,000 in liquid savings each year to fund a tax bill is a difficult ask, even when the long-term math clearly favors doing so.

The result is that many clients who would benefit most from systematic Roth conversions never start, or start too late. They reach age 73 with multi-million dollar pre-tax balances, facing RMDs that push them into the highest federal brackets, trigger Medicare IRMAA surcharges, and create concentrated taxable income events for their heirs.

The approach described here doesn't eliminate the tax cost of conversion — it simply changes where the money comes from to pay it. CPA's focus on **timing** the client's tax bill rather **than a conservative but active strategy**. (1)

## Covered Calls Inside the Qualified Plan: The Key Distinction

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The strategy begins with a structural shift in how the qualified account is managed. Rather than holding a *passive portfolio of low-cost index funds*, the account is invested in a diversified basket of equity Exchange Traded Funds (ETF's) on which the investment manager systematically writes covered calls — selling the right to purchase shares at a specified price in exchange for immediate premium income.

This is not an unusual strategy. Covered call writing is one of the most conservative and time-tested options approaches available and is permitted inside Traditional, Rollover IRAs and self-directed 401(k) plans that have received appropriate options approval from their custodian (Level 0 or Level 1 approval at most major custodians, including Schwab, Fidelity, and Interactive Broker).

What makes the application distinctive here is the **location** of the strategy. When covered calls are written in a taxable account, the premium income is taxed immediately — as short-term capital gains or ordinary income — at the investor's marginal rate. At a 30% bracket, a dollar of option premium becomes roughly 70 cents after tax.

Written inside a Rollover IRA or self-directed 401(k), that same dollar of premium accrues **tax-deferred within** the plan. One hundred cents compounds, not seventy. Over time, the difference in the account's growth trajectory is substantial.

A well-structured covered call program on a \$1 million equity portfolio can realistically generate an additional 4% to 12% in annual option premium income — meaning \$40,000 to \$120,000 in premium accruing tax-deferred inside the plan each year, alongside whatever the underlying equities appreciate.

### Why Location Matters: Inside vs. Outside the Plan

Inside a taxable account: \$100K option premium → ~\$70K after 30% tax → only \$70K reinvested

Inside a Rollover IRA: \$145K of option premium generated → \$100K tax-deferred → full \$100K compound inside Roth

The plan generates its own conversion fuel — no outside savings required

12%-18% gross return (8% equity + bond appreciation + 4%-12% in additional option income annually) sustains withdrawals while the account continues growing depending on ETF's and securities

### The Mechanics: How the Conversion Is Funded

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With the covered call structure in place, the annual Roth conversion follows a straightforward sequence. Using an illustrative example with a 30% effective tax rate:

**Step 1.** The Rollover IRA or self-directed 401(k) easily generates enough gross option premium income over the course of the year using weekly expiring options, accruing tax-deferred *inside* the plan. At time of this writing, with option expiration **12 days away**, the NASDAQ (symbol: QQQ) “out of the money” call options are trading at 37 bps, the Russell 2000 (symbol: IWM) 18bps and the iShares MSCI Emerging Markets (symbol: EEM) 30 bps of option premium. (3)

**Step 2.** The client and CPA together request the investment advisor to initiate a \$150,000 gross withdrawal, typically at the end of year from the qualified account, triggering ordinary income tax on the full amount.

**Step 3.** The \$45,000 tax liability (at the 30% effective rate) is funded by the option premium income the account generated over the course of the year. The premium covers the conversion tax — no principal is liquidated, and no outside savings are required.

**Step 4.** The remaining \$105,000 is contributed to a Roth IRA, where it compounds tax-free at 10% per year, with no RMDs and no future tax obligation.

***"Equity positions are never liquidated to fund the conversion. The underlying portfolio can remain intact and continues to appreciate."***

The underlying equity portfolio is never touched. Because the gross returns of the plan (8% equity + fixed income appreciation plus 4% to 12% annual option premium) can exceed the \$150,000 annual withdrawal on a \$1 million starting balance, the Rollover IRA balance continues to grow over time even as conversions are executed annually.

- This is a counterintuitive but important feature of the strategy: the account does not deplete in the way a normal standard conversion scenario might suggest.

Several caveats.

1. The option premium received varies depending on market volatility, but spread out across 3 or 4 different ETFs, the account can still maintain a low risk profile, with high risk-adjusted returns. (2)
2. Extreme sharp upside rallies can diminish portfolio returns since 10 days to 14 days options sold 3% to 5% out-of-the-money will need to be “rolled up and out”.

## **Twenty-Year Projection: What the Numbers Show**

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The table below illustrates the projected balances across a 20-year horizon, beginning with \$1 million in a Rollover IRA and a Roth IRA starting at zero — receiving \$105,000 in annual conversions from year one. Any taxable brokerage accounts are excluded here to isolate the performance of the qualified plan conversion strategy alone.

Assumptions: 30% effective tax bracket, 10% Roth IRA return, and 18% gross return inside the Rollover IRA (8% equity appreciation plus 10% covered call premium, compounding tax-deferred).

Year	Rollover IRA Balance	Roth Conversion Balance (Tax-Free)	Rollover IRA + Roth Combined
End of Year 5	\$1,214,626	\$641,036	<b>\$1,855,662</b>
End of Year 10	\$1,705,639	\$1,673,430	<b>\$3,379,069</b>
End of Year 15	\$2,828,958	\$3,336,111	<b>\$6,165,069</b>
End of Year 20	\$5,398,839	\$6,013,875	<b>\$11,412,714</b>

*Assumptions: \$1,000,000 starting Rollover IRA or 401(k) balance; Roth IRA starts at \$0. \$150,000 gross annual withdrawal; \$45,000 tax (30% effective bracket) funded by covered call option premium income generated inside the plan; \$105,000 net annual contribution to Roth IRA. Rollover IRA: 18% gross ROR (8% equity appreciation +fixed income+ 10% covered call premium), tax-deferred. Roth IRA: 10% ROR, tax-free compounding. No taxable account included in this projection. Projections are hypothetical and for illustrative purposes only.*

For context, a client who takes no action and simply allows a \$1 million 401(k) to grow at 10% annually for 20 years accumulates approximately \$6.7 million on paper — but after accounting for tax at a 30% effective rate on eventual RMDs, the real after-tax value is closer to \$4.7 million. The systematic Premium Roth conversion strategy, by contrast, produces a combined Roth plus taxable position of approximately **\$9.7 million** — a materially different outcome, and one that passes to heirs without the income tax burden attached to a pre-tax IRA.

## Client Profiles Where This Planning Is Most Relevant

Not every client is a candidate for this approach. The strategy works best where several conditions converge.

**Pre-RMD window (ages 60–72).** The optimal time to execute systematic conversions is in the years after a client's earned income has declined but before RMDs begin at age 73. In this window, the client's marginal rate is often lower than it will be once forced distributions layer on top of Social Security and other retirement income. Each year of inaction in this window is a year of conversion opportunity that cannot be recovered.

**Rollover IRA or 401(k) balances of \$500,000 or more.** The strategy requires sufficient assets within the qualified account to generate meaningful option premium

since “100 share round lots” are required to sell options. Portfolios below this threshold may not produce enough premium to fully cover the conversion tax, requiring some supplemental outside funding.

**Inherited IRA beneficiaries.** Under the SECURE Act, most non-spouse beneficiaries must fully deplete an inherited IRA within 10 years of the original owner's death. There are no required annual distributions in years one through nine — which means many beneficiaries do nothing for the first several years, then face a massive, fully taxable lump-sum distribution in year ten, stacked on top of their own income. A covered call strategy inside the inherited IRA, combined with a coordinated annual drawdown over the full 10-year period, can substantially reduce this exposure.

## **The Role of the CPA and Attorney**

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The Premium Roth Conversion is not a product — it is a coordinated planning strategy that requires close collaboration between the client's (option savvy) financial advisor, CPA, and estate planning attorney. Each professional brings an indispensable perspective.

The CPA is typically the first to identify the exposure. In reviewing a client's tax return or financial situation, the CPA sees the growing pre-tax balance, anticipates the RMD trajectory, and recognizes when the 10-year inherited IRA clock has started running. That awareness — and the willingness to surface it as a planning conversation — is often the catalyst that sets the strategy in motion.

The estate planning attorney plays a complementary role, particularly in situations involving inherited IRAs, trust beneficiaries, or estate planning structures where the Roth's no-RMD and asset-transfer characteristics interact with the client's broader legacy goals. A Roth IRA passed to heirs is not subject to income tax at distribution and, under current rules, provides a 10-year tax-free growth period for non-spouse beneficiaries — a meaningfully different inheritance than a pre-tax IRA of equivalent value.

For CPAs and attorneys who identify clients in the profiles described above, the most valuable action is simply raising the conversation: Has your client examined whether their qualified account balance could be generating the income needed to fund its own

conversion? In many cases, the answer will reveal a planning opportunity that no one has yet addressed.

## Practical Considerations and Compliance Notes

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- a. Covered call writing inside a qualified plan requires prior options approval from the account custodian — typically Level 0 or Level 1 options approval, which permits the writing of covered calls on positions held within the account. Not all custodians grant this approval automatically; clients may need to complete an options agreement and may receive a regulatory disclosure from the Option Industry Council. Most major retail custodians support this functionality for self-directed IRA accounts.
  - b. The strategy also requires active portfolio management. Unlike a passive index approach, a covered call program requires ongoing attention to strike prices, expiration dates, assignment risk, and position sizing. Clients should work with an advisor experienced in options management rather than attempting to execute the strategy independently.
  - c. On the tax side, the gross Roth conversion withdrawal is reported as ordinary income in the year it is taken. CPAs should model the conversion amount carefully each year to avoid pushing the client into a higher bracket than intended or triggering Medicare IRMAA surcharges, which are based on modified adjusted gross income from two years prior. In many cases, the optimal annual conversion amount will be determined not by the option premium generated but by the client's marginal rate bracket ceiling.
  - d. While stock market returns are not linear, the industry assumes a typical 70% equity portfolio 30% fixed income would provide a 6% to 12% annual rate of return depending on ETF composition, with a Nitrogen Risk score (formerly Riskalyze) of 73 or higher. Each client needs to have a conversation with their investment advisor to construct a portfolio that has the potential to generate enough income annually. Experience teaches us that market returns can vary wildly in any given year, yet the income credit received every two to four weeks from selling option premium is still attractive.
  - e. A portfolio consisting of 30% QQQ, 10% SPY, 10% EEM, 15% IWM, 15% US Treasury's, 15% High Yield Corporate Bonds and a 5% allocation to “spicy” technology stocks can achieve most, if not all the income needed to offset Federal withholding for the conversion with a risk tolerance score of “66” on a scale of 1 to 99.
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## Conclusion

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The Roth conversion is one of the most durable strategies in tax planning — a rare opportunity to pay a known tax liability today in exchange for permanently eliminating an uncertain and potentially larger liability in the future.

What the covered call approach adds is a self-funding mechanism that removes the primary obstacle to execution: the need to draw on outside savings to pay the conversion tax each year.

For CPAs and estate attorneys working with clients who hold meaningful qualified retirement assets, this is a planning conversation worth having.

The window is open.

The math is compelling.

And the option premium income to fund the strategy is often already there — sitting inside the account, waiting to be put to work.

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### About the Author

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Footnotes:

1. Characteristics and Risks of Standardized Options- <https://tinyurl.com/yufx73pw>
2. OIC Covered Call Strategy page (best for a general reference):  
<https://www.optioneducation.org/strategies/all-strategies/covered-call-buy-write>
3. OIC Free Covered Call Course (most comprehensive):  
<https://education.optioneducation.org/course/view.php?id=7>

*SUBMISSION NOTE: This article falls under Insight's "Tax, Accounting, and Financial Reporting" and "Financial Planning" topic categories. Word count: approximately 2,498 words. Submitted exclusively to Amy Sanchez. No products, services, or calls-to-action are promoted in the article body. Submitted to SanchezA@icpas.org*