Roth vs. Traditional IRAs: You need to decide in 2010

Generally, contributions to traditional IRAs are tax deductible. However, once you withdraw from a traditional IRA, it is taken as taxable income. Roth IRA contributions, on the other hand are not deductible. In other words, when you contribute to a Roth, you pay taxes on that money immediately. The benefit, however, is that money can grow indefinitely and when withdrawn, you won't pay taxes.

Roth IRAs are more beneficial as:

- Your future tax rate increases
- Your length of time until you withdraw increases

Regular IRAs are more beneficial as:

- Your current tax rate decreases
- Your expectation of "game changing" events is lower. In addition, Roth IRAs do not have the required minimum distributions that Traditional IRAs do and enjoy more liberal withdrawal rules.

WHY 2010?

Conversions from Traditional IRAs to Roth IRAs has been limited if your modified adjusted gross income has been above $100,000 for couples filing jointly. In 2010 only, this restriction will be lifted In addition, taxes due on the amounts converted can be spread over 2011 and 2012 — effectively reducing your tax rate. While limitations on conversions are lifted for 2010, the limitation on contributions to IRAs has not been waived.

RULES OF THUMB

- If you believe your tax rates will drop during the withdrawal period, it likely does not make sense.
- If you believe your tax rate will increase, it likely does make sense.
- If you do not have cash to comfortably pay the taxes due, it likely does not make sense.
- If you do not have a long time horizon (5 to 10 years) for the tax-free compounding to occur, it likely does not make sense.

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