Betterment Tax Loss Harvesting

[Editor's Note: This is a guest post submitted to me months ago by radiologist Toshi Clark, MD, with whom I have no financial relationship. It is about Betterment, one of the "robo-advisors," which is trying to fill a niche between do-it-yourselfers and a full-service "human" advisor. Dr. Clark has no financial relationship with Betterment (not even as a client), but I technically do. I don't think I've ever made much money off an affiliate advertising relationship I have with [Betterment,](#) but if you decide to sign-up with them through links on this page, this website gets a small commission. Enjoy the piece.]

Background

[Betterment](#) is one of many new robo advisor services. They offer an automated [tax loss harvesting](#) service, "TLH+," as part of their standard management fee for accounts with holdings greater than $50,000 (including both taxable account and traditional IRA holdings). Their fee is 0.25% annually for accounts $50,000-$99,999, and 0.15% annually for $100,000+. While the fees haven't changed since 2012, TLH+ is a new offering as of 2014 that is arguably very relevant to attending physicians with taxable investment accounts.

TLH+

Betterment wrote a [white paper on TLH+](#), which presents data that suggests their algorithm, with very reasonable assumptions on marginal tax rates given an attending physician audience, will produce gains of about twice that of simpler automated tax loss harvesting algorithms extant. For the cynics, these predicted gains are roughly an order of magnitude greater than their 0.15% fee. They accomplish this by harvesting losses on assets that decline in value and then switching funds between correlated-performance but not identical holdings in primary, secondary, and tertiary classes (with the distinction being increasing fees in the non-primary classes). The algorithm performs this harvesting daily to maximize the up to $3,000 yearly income deduction from harvested losses (with further losses beyond this amount carried forward), minimize fund fees, avoid short term capital gains entirely, and avoid violating the Wash Sale Rule.

This potential income deduction of up to $3,000 represents arbitrage between current marginal income rates and future long term capital gains rates rather than a permanent gain. However, for most pre-retirement attendings reading WCI this will be a welcome trade off due to their current high marginal income tax rates, and there's the further benefit of the interest one might earn in the future on the money saved through deferring income taxes.

IRAs Too?

This tax loss harvesting is only applicable by definition to taxable investment accounts. What about tax-deferred accounts? Betterment can manage one's tax-deferred funds, too, via a rollover/transfer to a traditional IRA managed by them. The idea behind doing this is that unified management would allow for intelligent rebalancing between asset classes across one's entire portfolio, as referenced in WCI's original 2012 post referencing Betterment, for optimal distribution of assets such as bonds between the accounts based on maximizing post-tax return, and that their algorithm will be able to automatically avoid violation of the Wash Sale Rule globally.

I am of the opinion that having Betterment manage tax-deferred accounts doesn't make sense despite these potential benefits, for several reasons beyond the lack of tax loss harvesting in tax-protected accounts:

1) Target Retirement Fund Strategy in Tax-Protected

One can avoid the Wash Sale Rule simply by holding and continuing to buy target date funds in one's tax-deferred accounts. Most individuals' overall holding strategies will probably be reasonably close in composition to those in a target date fund, so minor discrepancies between the taxable and tax-deferred sides won't affect outcome that much.

2) Lower Fees

Not having Betterment manage one's tax-deferred holdings will save that 0.15% fee on that portion of one's savings, to state the obvious. For those who have large tax-deferred spaces in which to play (as opposed to those limited by the standard $18,000 employee contribution limit for 401(k) participants), the case with WCI and I, this may represent 0.15% of a substantial amount.

3) No Backdoor Roth

Rolling over one's tax-deferred accounts into a Betterment (traditional) IRA would effectively rule out backdoor Roth conversions due to the pro rata rule.

Whether to use a service such as Betterment ultimately is an individual choice, but I think their introduction of TLH+ makes their 0.15% fee seem reasonable for management of taxable investment accounts. I'd probably not be vigilant about tax loss harvesting if doing it manually, not to mention that their daily algorithmic approach promises better results, yet I and other readers of WCI stand to benefit from this technique the most due to our high marginal tax rates.

If you sign up for Betterment through this link, not only do I get a commission, but right now they have a promotion where you get to save the first 3-6 months of fees. On a $100K investment, that's a $38-75 value.

What do you think? Do you use Betterment? Would you consider it for the TLH+ service? Do you feel this is worth 0.15% per year? Comment below!