

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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subject: Payment obligations for purposes of § 1.752-2(b)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether a limited partner's conditional obligation to restore a deficit balance in the partner's capital account is recognized as an obligation to make a payment for a partnership liability under § 1.752-2(b) of the Income Tax Regulations.

ANSWER

A limited partner's conditional obligation to restore a deficit balance in the partner's capital account is not a payment obligation under § 1.752-2(b).

FACTS

Partnership is a limited partnership comprised of limited partners and a general partner. Partnership is governed by a Partnership Agreement. Under the Partnership Agreement, no limited partner is liable for any partnership obligation.

In the case of a limited partner with a deficit balance in the partner's capital account, the Partnership Agreement provides that the general partner may demand such limited partner contribute cash to the Partnership to restore the deficit balance. If the limited partner fails to make such contribution, the Partnership Agreement provides that the general partner may (but is not required to) withhold distributions otherwise payable to the limited partner up to an amount that would eliminate the deficit balance in the partner's capital account. The Partnership Agreement provides for no other recourse against the limited partner for the partner's failure to restore the deficit balance. Further, the Partnership Agreement does not require a limited partner with a deficit balance in the partner's capital account to restore such deficit upon the liquidation of the Partnership.

LAW

Section 1.752-1(a)(1) provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability under § 1.752-2.

Section 1.752-2(b)(1) provides that, except as otherwise provided in § 1.752-2, a partner bears the economic risk for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner.

Section 1.752-2(b)(3)(i) provides that the determination of the extent to which a partner or related person has an obligation to make a payment under § 1.752-2(b)(1) is based on the facts and circumstances at the time of the determination. To the extent that the obligation of a partner or related person to make a payment with respect to a partnership liability is not recognized under § 1.752-2(b)(3), § 1.752-2(b) is applied as if the obligation did not exist. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying § 1.752-2(b), including: (A) contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors, to other partners, or to the partnership; **(B) obligations to the partnership that are imposed by the partnership agreement, including the obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership as described in § 1.704-1(b)(2)(ii)(b)(3) (taking into account § 1.704-1(b)(2)(ii)(c));** and (C) payment obligations (whether in the form of direct remittances to another partner or a contribution to the partnership) imposed by state or local law, including the governing state or local law partnership statute. (Emphasis added).¹

¹ The payment obligation that is the subject of this Chief Counsel Advice does not implicate § 1.752-2(b)(3)(i)(A) or (C).

Section 1.704-1(b)(2)(ii)(b)(3) describes an obligation where, if a partner has a deficit balance in the partner's capital account following the liquidation of the partner's interest in the partnership, as determined after taking into account all capital account adjustments for the partnership taxable year during which such liquidation occurs (other than those made pursuant to § 1.704-1(b)(2)(ii)(b)(3)), the partner is **unconditionally obligated** to restore the amount of such deficit balance to the partnership by the end of such taxable year (or, if later, within 90 days after the date of such liquidation). (Emphasis added).

Section 1.704-1(b)(2)(ii)(c)(1) provides that if a partner is not expressly obligated to restore the deficit balance in such partner's capital account, such partner nevertheless will be treated as obligated to restore the deficit balance in the partner's capital account (in accordance with the requirement in § 1.704-1(b)(2)(ii)(b)(3) and subject to § 1.704-1(b)(2)(ii)(c)(2)) to the extent of: (A) The outstanding principal balance of any promissory note (of which such partner is the maker) contributed to the partnership by such partner (other than a promissory note that is readily tradable on an established securities market), and (B) The amount of any **unconditional obligation** of such partner (whether imposed by the partnership agreement or by state or local law) **to make subsequent contributions to the partnership** (other than pursuant to a promissory note of which such partner is the maker). (Emphasis added).

DISCUSSION

Section 1.752-2(b)(3)(i)(B) describes obligations that are taken into account for purposes of applying § 1.752-2(b), including a valid deficit restoration obligation (DRO) under § 1.704-1(b)(2)(ii)(b)(3) or an obligation that satisfies § 1.704-1(b)(2)(ii)(c)(1). The conditional obligation that is the subject of this Chief Counsel Advice is not an obligation for purposes of § 1.752-2(b)(3)(i)(B) because it fails to satisfy the requirements under either § 1.704-1(b)(2)(ii)(b)(3) or § 1.704-1(b)(2)(ii)(c)(1). Therefore, it is not a payment obligation for purposes of § 1.752-2(b).

To meet the requirements of a valid DRO under § 1.704-1(b)(2)(ii)(b)(3), a DRO must be an unconditional obligation to restore the amount of the deficit balance in the partner's capital account to the partnership following the liquidation of the partner's interest in the partnership. An obligation that does not meet the requirements of § 1.704-1(b)(2)(ii)(b)(3) may nevertheless be respected as an obligation to restore a deficit balance in the partner's capital account if such an obligation meets the requirements of § 1.704-1(b)(2)(ii)(c)(1). But to satisfy § 1.704-1(b)(2)(ii)(c)(1), an obligation also must be unconditional. Here, the obligation of a limited partner to restore a deficit balance in the partner's capital account is conditioned upon demand by the general partner and the Partnership Agreement does not require a limited partner to restore any deficit balance upon liquidation of the Partnership; therefore, the payment obligation is conditional and does not qualify as an obligation to restore a deficit balance in a partner's capital account under § 1.704-1(b)(2)(ii)(b)(3) or § 1.704-1(b)(2)(ii)(c)(1).

Arguably § 1.752-2(b)(3)(i)(B) recognizes any payment obligation to the partnership imposed by a partnership agreement, with obligations described in § 1.704-1(b)(2)(ii)(b)(3), taking into account § 1.704-1(b)(2)(ii)(c), included only as examples. However, the obligation to the partnership must still be a payment obligation under § 1.752-2(b)(1) for a partner to bear economic risk of loss for a partnership liability. Under § 1.752-2(b)(1), a partner bears the economic risk of loss for a partnership liability if, upon the constructive liquidation of the partnership, the partner or related person would be obligated to make a contribution to the partnership. Under § 1.752-2(b)(3)(i), the extent to which a partner is obligated to make a payment under § 1.752-2(b)(1) is based upon the facts and circumstances at the time of the constructive liquidation. In this case, if Partnership liquidates, the Partnership Agreement does not compel a limited partner with a deficit balance in its capital account to make a contribution to the Partnership. Therefore, a limited partner does not bear the economic risk of loss under § 1.752-2(b)(1) for a partnership liability.

CONCLUSION

Because a limited partner's conditional obligation is not a payment obligation under § 1.752-2(b), the limited partner does not bear the economic risk of loss for a partnership liability.

Please call John Hanebuth (202) 317-6850 if you have any further questions.