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NASDAQ	3,065.02	-47.33	-1.52%	

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Illinois Lawmakers Pass 67% Income Tax Increase

By Tim Jones - Jan 12, 2011 11:32 AM ET

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Illinois lawmakers in the waning hours of their term passed a 67 percent income-tax increase, the largest in the state's history, to help close a \$13 billion budget deficit.

The boost in the tax rate to 5 percent from 3 percent was approved by both chambers. Governor Pat Quinn, a Democrat, has supported an increase. A new Legislature will be sworn in today.



Pat Quinn, governor of Illinois
 Photographer: Tim Boyle/Bloomberg



Jan 12 (Bloomberg) -- Bill Gross, manager of the world's largest bond fund at Pacific Investment Management Co., discusses the debt sold today at auction by Portugal Gross, who speaks with Margaret Brennan on Bloomberg Television's "InBusiness;" also talks about the municipal bond market, Federal Reserve policy and investment strategy (Source: Bloomberg)



Jan 12 (Bloomberg) -- Jonathan Henes, a bankruptcy attorney at Kirkland & Ellis LLP, discusses the need for legislation allowing U.S. states to file for Chapter 11 bankruptcy protection. Henes talks with Margaret Brennan on Bloomberg Television's "InBusiness" (Source: Bloomberg)

The increase, intended to last through 2014, is aimed at fixing Illinois's worst fiscal crisis, including a backlog of more than \$6 billion in unpaid bills and almost \$4 billion in missed payments to underfunded state pensions. The deficit amounts to about half of planned general-fund spending for this fiscal year, which ends in June.

"The wolf is at the door and we have some very difficult decisions to make," said Representative Gregory Harris, a Democrat from Chicago. Democrats in the House of Representatives passed the measure by the minimum necessary vote, 60-57, with no Republican support.

The Senate yesterday also approved a measure to allow the state to borrow \$3.7 billion for this fiscal year's pension payment. Quinn has said he will sign the bill, which passed the House in May.

Budget-Balancing

Raising the income-tax rate to 5 percent would generate an extra \$6 billion in revenue annually, Illinois Budget Director David Vaught estimated in a July interview. Illinois and other U.S. states will confront deficits totaling \$140 billion in the next fiscal year, according to a Dec. 16 report from the Center on Budget and Policy Priorities, a Washington research group.

"There are some actions being taken," Bill Gross, manager of the world's biggest bond fund at Pacific Investment Management Co., said today in a Bloomberg Television interview with Margaret Brennan. "Illinois -- hooray!"

Richard Ciccarone, managing director of McDonnell Investment Management LLC in Oak Brook, Illinois, said, "It's going to take a long time for the state to rebuild the trust of the marketplace."

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His firm holds more than \$7 billion of municipal bonds.

"Investors are concerned about the sustainability of the state's finances to weather future downturns," he said. "You can't just keep raising taxes every time there's a downturn."

Two Bills Died

Two other elements of the Democrats' budget-balancing plan failed in the House -- a \$1 per-pack increase in the cigarette tax and authorization for \$8.5 billion in bonds to cover the backlog of unpaid bills.

The state's flat-rate levy on income ranks lower than most in the Midwest, according to a February report by the Federation of Tax Administrators in Washington. Indiana was lowest at 3.4 percent, followed by Michigan, at 4.35 percent. The top rates were 7.85 percent in Minnesota, 6.24 percent in Ohio and 8.98 percent in Iowa, the study showed.

Quinn, elected to his first full term in November, has said that one percentage-point of the income-tax increase, or about \$3 billion by Vaught's analysis, should be dedicated to education.

The widening gap between Illinois's expenses and revenue has drawn criticism from Moody's Investors Service. The imbalance, and the state's practice of delaying bill payments, underscores its "chronic unwillingness to confront a long-term, structural budget deficit," Moody's said in a Dec. 29 study.

Borrowing for Bills

The state continues to borrow to pay its bills. In November, the state sold \$1.5 billion of bonds backed by tobacco-settlement payments to help pay vendors.

The state had \$64 billion of pension assets to pay estimated liabilities of \$126.4 billion as of June, about half the amount needed for almost 723,000 workers, retirees and other beneficiaries, according to bond documents.

Illinois and California are rated A1 by Moody's, the fifth-highest investment grade and the lowest level for any state's general-obligation debt. Standard & Poor's rates Illinois slightly higher, at A+, its fifth highest grade, than California, which it gives an A-, four steps above junk status. In September, Moody's forecast possible "further financial deterioration" in Illinois, citing budget issues.

Illinois and Arizona were the weakest states in a Dec. 30 financial-strength index report from BMO Capital Markets analysts led by Justin Hoogendoorn in Chicago.

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