MUNICIPAL HIGH INCOME FUND INC
Form N-CSR
January 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number **811-5497**

Municipal High Income Fund Inc.
(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY 10004
(Address of principal executive offices) (Zip code)

Robert I. Frenkel, Esq.
Legg Mason & Co., LLC
300 First Stamford Place, 4th Floor
Stamford, CT 06902
(Name and address of agent for service)

Registrant's telephone number, including area code: (800) 451-2010
Date of fiscal year end: **October 31**
Date of reporting period: **October 31, 2005**

ITEM 1. REPORT TO STOCKHOLDERS.

The **Annual** Report to Stockholders is filed herewith.

Municipal High Income
Fund Inc.

OCTOBER 31, 2005

INVESTMENT PRODUCTS: NOT FDIC INSURED   NO BANK GUARANTEE   MAY LOSE VALUE

Municipal High Income Fund Inc.

Annual October 31, 2005

Letter from the Chairman

Dear Shareholder,

R. JAY GERKEN, CFA
Chairman, President and
Chief Executive Officer

The U.S. economy was surprisingly resilient during the fiscal year. While surging oil prices, rising interest rates, and the impact of Hurricanes Katrina and Rita threatened to derail the economic expansion, growth remained solid throughout the period. After a 3.3% advance in the second quarter of 2005, third quarter gross domestic product (GDP[i]) growth grew to 4.3%, marketing the tenth consecutive quarter in which GDP growth grew 3.0% or more.

As expected, the Federal Reserve Board (Fed[ii]) continued to raise interest rates in an attempt to ward off inflation. After raising rates three times from June 2004 through September 2004, the Fed increased its target for the federal funds rate[iii] in 0.25% increments eight additional times over the reporting period. The Fed again raised rates in early November, after the Fund s reporting period had ended. All told, the Fed s twelve rate hikes have brought the target for the federal funds rate from 1.00% to 4.00%. This represents the longest sustained Fed tightening cycle since 1976-1979.

During much of the fiscal year, the fixed income market confounded investors as short term interest rates rose in concert with the Fed rate tightening, while longer-term rates, surprisingly, declined. However, due to a spike late in the period, the 10-year Treasury yield was 4.56% on October 31 2005, versus 4.11% when the period began. Nevertheless, this was still lower than its yield of 4.62% when the Fed began its tightening cycle on June 30, 2004. This trend also occurred in the municipal bond market.

Please read on for a more detailed look at prevailing economic and market conditions during the Fund s fiscal year and to learn how those conditions have affected Fund performance.

Special Shareholder Notice

On December 1, 2005, Citigroup Inc. (Citigroup) completed the sale of substantially all of its asset management business, Citigroup Asset Management, to Legg Mason, Inc. (Legg Mason). As a result, the Fund s investment adviser (the Manager), previously an indirect wholly owned subsidiary of Citigroup, has become a wholly-owned subsidiary of Legg Mason. Completion of the sale caused the Fund s existing investment management contract to terminate. The Fund s shareholders previously approved a new investment management contract between the Fund and the Manager, which became effective on December 1, 2005.

Effective January 1, 2006, the Fund s board has approved the appointment of Joseph P. Deane and David T. Fare as co-portfolio managers of the Fund.

Information About Your Fund

As you may be aware, several issues in the mutual fund industry have recently come under the scrutiny of federal and state regulators. The Fund s Manager and some of its affiliates have received requests for information from various government regulators regarding market timing, late trading, fees, and other mutual fund issues in connection with various investigations. While these issues do not directly affect your Fund, the Fund has been informed that the Manager and its affiliates are responding to those information requests, but are not in a position to predict the outcome of these requests and investigations.

Important information concerning the Fund and its Manager with regard to recent regulatory developments is contained in Notes to the Financial Statements included in this report.

As always, thank you for your confidence in our stewardship of your assets. We look forward to helping you continue to meet your financial goals.

Sincerely,

R. Jay Gerken, CFA
Chairman, President and Chief Executive Officer

December 19, 2005

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

i Gross domestic product is a market value of goods and services produced by labor and property in a given country.

ii The Federal Reserve Board is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

iii The federal funds rate is the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans.

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Manager Overview

PETER M. COFFEY
Vice President and
Investment Officer

Q. What were the overall market conditions during the Fund s reporting period?

A. The U.S. economy continued to grow at a solid pace throughout the period, with gross domestic product (GDP[i]) surpassing 3.0% in each quarter covered by this report. Given the strength of the economy and rising oil prices triggering inflationary concerns, the Federal Reserve Board (Fed[ii]) continued to raise short-term interest rates at a measured pace. While there were expectations that the Fed might pause in its tightening cycle following the devastation wrought by Hurricanes Katrina and Rita, it continued to raise rates. In its statement accompanying the September 2005 rate hike the Fed said: The widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production, and unemployment will be set back in the near term. While these unfortunate developments have increased uncertainty about near-term economic performance, it is the Committee s view that they do not pose a more persistent threat.

Turning to the municipal bond market, new bond issuance continued to be very strong during the reporting period. In 2004, $358 billion in new municipal securities was issued, the third largest amount during a calendar year. This trend has continued thus far in 2005, as a record for first half-year new issuance was established, with $206 billion in new municipal debt. Overall, the abundance of new supply was met with strong demand, especially by institutions and property and casualty insurers.

The current market is characterized by relatively low long-term bond yields and still rising short-term interest rates. Credit quality spreads (the difference in yield between high-, medium- and low-grade credits) are also very narrow by historical standards. In this environment, purchasers of high yield securities are being paid comparatively little incremental yield for taking interest rate or credit risk.

During the fiscal year, the shorter end of the municipal bond yield curve generated the weakest results, while longer-term securities outperformed. Over the same period, lower quality municipals outperformed their higher quality counterparts.

Performance Review

For the 12 months ended October 31, 2005, Municipal High Income Fund Inc. returned 2.16%, based on its New York Stock Exchange (NYSE) market price and 7.82% based on its net asset value (NAV[iii]) per share. In comparison, the unmanaged Lehman

Brothers Municipal Bond Index,[iv] returned 2.54% and the Lipper High Yield Municipal Debt Closed-End Funds Category Average[v] increased 8.20% over the same time frame. Please note that Lipper performance returns are based on each Fund s NAV.

Certain investors may be subject to the Federal Alternative Minimum Tax, and state and local taxes may apply. Capital gains, if any, are fully taxable. Please consult your personal tax or legal adviser.

During the 12-month period, the Fund made distributions to shareholders totaling $0.4490 per share. The performance table shows the Fund s 30-day SEC yield as well as its 12-month total return based on its NAV and market price as of October 31, 2005. **Past performance is no guarantee of future results. The Fund s yields will vary.**

Price Per Share	30-Day SEC Yield	12-Month Total Return
$7.95 (NAV)	**5.46%**	**7.82%**
$7.10 (Market Price)	**6.12%**	**2.16%**

All figures represent past performance and are not a guarantee of future results. The Fund s yields will vary.
Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions, including returns of capital, if any, in additional shares. The SEC yield is a return figure often quoted by bond and other fixed-income mutual funds. This quotation is based on the most recent 30-day (or one-month) period covered by the Fund s filings with the SEC. The yield figure reflects the income dividends and interest earned during the period after deduction of the Fund s expenses for the period. These yields are as of October 31, 2005 and are subject to change.

Q. What were the most significant factors affecting Fund performance?

What were the leading contributors to performance?

A. During the fiscal year, the Fund s securities in the tobacco sector enhanced results. This was largely due to positive developments on the litigation front. As a result, investors had a favorable outlook on securities that are backed by revenues from the Master Settlement Agreement between states and tobacco companies. Our education bonds also performed well, with one non-rated student housing issue gaining substantially as a result of an advance refunding.

The Fund s transportation holdings contributed to performance as well. In particular, our toll road holdings recovered substantially. We took the opportunity to sell our below investment grade zero coupon bond toll road holdings to reduce interest rate and credit quality risk. We also sold our holdings in two airport special facilities issues for airlines that filed for bankruptcy protection U.S. Air and Northwest at higher prices than they were valued at the beginning of the period. Finally, several miscellaneous holdings benefited from generally improving credit quality and narrowing credit quality spreads.

What were the leading detractors from performance?

A. The Fund s multi-family low income housing securities detracted from results as one issue defaulted and lost most of its value. In addition, several other distressed holdings in this sector were sold at substantial losses. Our high quality, short maturity pre-refunded holdings were also a drag on performance during the fiscal year. This was due to the fact that shorter term rates rose substantially while long term rates were relatively stable. Elsewhere, several of the Fund s high coupon bonds were called (or retired) when they reached their first optional call date. This resulted in reduced income for the Fund.

Our hedging strategies detracted from performance. Our short positioning strategy in long-term Treasury futures enhanced results when longer-term rates rose, particularly in the last two months of the period. However, while this strategy reduced the portfolio s volatility, overall it was detrimental as long-term yields declined over much of the fiscal year, even though the Fed continued to raise short-term rates.

Q. Were there any significant changes to the Fund during the reporting period?

A. Over the fiscal year, we took advantage of favorable market conditions to reduce the Fund s exposure in the life care, tobacco and transportation sectors. In addition, commitments were pared in multi-family housing, which has remained an area of concern. Holdings in the industrial development and pollution control segments declined as several older high coupon issues were called as they reached optional call dates. Positions in education and hospitals increased primarily because they represented better values at the time cash was available, rather than for any sector related strategy. Pre-refunded bonds also increased as the low interest rate environment enabled issuers to refinance at lower rates by advance refunding several issues in our portfolio.

Looking for Additional Information?

The Fund is traded under the symbol MHF and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under symbol XMHFX. *Barron s* and *The Wall Street Journal s* Monday editions carry closed-end fund tables that will provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites as well as www.citigroupam.com.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-735-6507, Monday through Friday from 8:00 a.m. to 6:00 p.m. Eastern Time, for the Fund s current net asset value, market price, and other information.

Thank you for your investment in the Municipal High Income Fund Inc. As ever, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the fund s investment goals.

Sincerely,

Peter M. Coffey

Vice President and Investment Officer

December 1, 2005

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

The mention of sector breakdowns is for informational purposes only and should not be construed as a recommendation to purchase or sell any securities. The information provided regarding such sectors is not a sufficient basis upon which to make an investment decision. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies discussed should consult their financial professional. Portfolio holdings are subject to change at any time and may not be representative of the portfolio manager s current or future investments. The Fund s top five sector holdings (as a percentage of net assets) as of October 31, 2005 were: Hospitals (16.1%), Miscellaneous (14.9%), Education (13.2%), Pre-refunded (9.9%) and Life Care Systems (6.2%). The Fund s portfolio composition is subject to change at any time.

RISKS: The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on fund performance. High yield bonds involve greater credit and liquidity risks than investment grade bonds. Certain investors may be subject to the Federal Alternative Minimum Tax (AMT), and state and local taxes may apply. Capital gains, if any, are fully taxable.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

i Gross domestic product is a market value of goods and services produced by labor and property in a given country.

ii The Federal Reserve Board is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

iii NAV is calculated by subtracting total liabilities and outstanding preferred stock from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is at the Fund s market price as determined by supply of and demand for the Fund s shares.

iv The Lehman Brothers Municipal Bond Index is a broad measure of the municipal bond market with maturities of at least one year.

v Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 12-month period ended October 31, 2005, including the reinvestment of distributions, including returns of capital, if any, calculated among the 15 funds in the Fund s Lipper category, and excluding sales charges.

Take Advantage of the Fund s Dividend Reinvestment Plan!

As an investor in the Fund, you can participate in its Dividend Reinvestment Plan (Plan), a convenient, simple and efficient way to reinvest your dividends and –capital gains, if any, in additional shares of the Fund. A more complete description of the Plan begins on page 44. Below is a short summary of how the Plan works.

Plan Summary

If you are a Plan participant who has not elected to receive your dividends in the form of a cash payment, then your dividend and capital gain distributions will be reinvested automatically in additional shares of the Fund.

The number of shares in the Fund you will receive in lieu of a cash dividend is determined in the following manner. If the market price of the shares is equal to or higher than 98% of the net asset value (NAV) per share on the date of valuation, you will be issued shares for the equivalent of either 98% of the most recently determined NAV per share or 95% of the market price, whichever is greater.

If 98% of the NAV per share at the time of valuation is greater than the market price of the common stock, the Fund will buy shares for your account in the open market or on the New York Stock Exchange.

If the Fund begins to purchase additional shares in the open market and the market price of the shares subsequently rises above 98% of the NAV before the purchases are completed, the Fund will attempt to cancel any remaining orders and issue the remaining dividend or distribution in shares at 98% of the Fund s NAV per share. In that case, the number of Fund shares you receive will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares.

To find out more detailed information about the Plan and about how you can participate, please call PFPC Inc. at 1 (800) 331-1710.

16.1%

13.2%

9.9%

6.2%

5.8%

5.1%

4.9%

4.4%

4.3%

2.8%

2.8%

2.7%

2.3%

1.8%

0.8%

0.8%

0.6%

0.6%

0.0%

5.0%

10.0%

20.0%

15.0%

As a Percent of Total Investments

Fund at a Glance (unaudited)

Hospitals

Education

Pre-Refunded

Lifecare Systems

Industrial Development

Transportation

Pollution Control

Public Facilities

Utilities

Housing: Multi-Family

Cogeneration Facilities

Tobacco

Housing: Single-Family

General Obligations

Water & Sewer

Escrowed to Maturity

Government Facilities

Tax Allocation

Miscellaneous

14.9%

October 31, 2005

MUNICIPAL HIGH INCOME FUND INC.

Face Amount	Rating	Security	Value
MUNICIPAL BONDS 94.6%			
Alabama 0.7%			
$ 615,000	NR	Capstone Improvement District of Brookwood, AL, Series A, 7.700% due 8/15/23 (a)	$ 61,500
1,000,000	AAA	West Jefferson, AL, Amusement & Public Park Authority Revenue, Visionland Project, Call 12/1/06 @ 102, 8.000% due 12/1/26 (b)	1,071,410
		Total Alabama	1,132,910
Alaska 2.9%			
1,055,000	NR	Alaska Industrial Development & Export Authority Revenue, Williams Lynxs Alaska Cargoport, 8.125% due 5/1/31 (c)	1,051,054
		Alaska State Housing Financial Corp., General Housing:	
2,000,000	AAA	Series A, FGIC-Insured, 5.000% due 12/1/26 (d)	2,066,240
1,650,000	AAA	Series B, MBIA-Insured, 5.250% due 12/1/30	1,738,803
		Total Alaska	4,856,097
Arizona 3.1%			
1,500,000	NR	Casa Grande, AZ, IDA, Hospital Revenue, Casa Grande Regional Medical Center, Series A, 7.625% due 12/1/29	1,644,555
935,000	NR	Maricopa County, AZ, IDA, MFH Revenue, Gran Victoria Housing LLC Project, Series B, 10.000% due 5/1/31 (e)	937,711
1,780,000	NR	Phoenix, AZ, IDA, MFH Revenue, Ventana Palms Apartments Project, Series B, 8.000% due 10/1/34	1,510,775
1,000,000	AAA	Yuma & La Paz Counties, Arizonal Community College District, Arizona Western College, FSA-Insured, 5.000% due 7/1/24	1,035,590
		Total Arizona	5,128,631
Arkansas 1.1%			
		Arkansas State Development Financing Authority:	
1,000,000	BBB	Hospital Revenue, Washington Regional Medical Center, Call 2/1/10 @ 100, 7.375% due 2/1/29 (b)	1,151,530
600,000	BB+	Industrial Facilities Revenue, Potlatch Corp. Projects, Series A, 7.750% due 8/1/25 (c)	679,590
		Total Arkansas	1,831,120
California 10.6%			
1,500,000	NR	Barona, Band of Mission Indians, CA, 8.250% due 1/1/20 (e)	1,564,260
2,000,000	A3(f)	California Health Facilities Financing Authority Revenue, Refunding, Cedars-Sinai Medical Center, 5.000% due 11/15/27	2,025,160
		California State Department of Water Resources & Power Supply Revenue, Series A:	
5,000,000	AAA	MBIA-IBC-Insured, Call 5/1/12 @ 101, 5.375% due 5/1/21 (b)(d)	5,395,700
1,500,000	AAA	XLCA-Insured, Call 5/1/12 @ 101, 5.375% due 5/1/17 (b)	1,633,020
1,500,000	NR	California Statewide CDA Revenue, East Valley Tourist Project, Series A, 9.250% due 10/1/20	1,637,385

See Notes to Financial Statements.

Face Amount	Rating	Security	Value
California 10.6% (continued)			
		Golden State Tobacco Securitization Corp., California Tobacco Settlement Revenue:	
$ 2,000,000	BBB	Asset Backed, Series A-4, 7.800% due 6/1/42 (d)	$ 2,434,060
1,000,000	A-	Enhanced Asset Backed, Series B, Call 6/1/13 @ 100, 5.625% due 6/1/38 (b)	1,116,370
1,865,000	Ba2(f)	Vallejo, CA, COP, Touro University, 7.375% due 6/1/29	1,956,143
		Total California	17,762,098
Colorado 4.0%			
500,000	NR	Beacon Point Metropolitan District, GO, Series A, 6.250% due 12/1/35	498,825
		Colorado Educational & Cultural Facilities Authority Revenue: Charter School:	
1,230,000	AAA	Bromley School Project, Refunding, XLCA-Insured, 5.125% due 9/15/25	1,286,642
845,000	AAA	Peak to Peak Project, Call 8/15/11 @100, 7.500% due 8/15/21 (b)	984,095
2,000,000	NR	Colorado Lutheran High School Association Project, Series A, 7.625% due 6/1/34 (d)	2,083,360
785,000	NR	Elbert County Charter, 7.375% due 3/1/35	785,126
500,000	NR	High Plains, CO, Metropolitan District, Series A, 6.250% due 12/1/35	498,825
500,000	NR	Southlands, CO, Metropolitan District Number 1, GO, 7.125% due 12/1/34	543,715
		Total Colorado	6,680,588
District of Columbia 1.2%			
1,895,000	AAA	District of Columbia COP, District Public Safety & Emergency, AMBAC-Insured, 5.500% due 1/1/20 (d)	2,054,085
Florida 12.5%			
1,000,000	NR	Beacon Lakes, FL, Community Development District, Special Assessment, Series A, 6.900% due 5/1/35	1,087,600
1,500,000	NR	Bonnet Creek Resort Community Development District, Special Assessment, 7.500% due 5/1/34	1,643,310
2,000,000	NR	Capital Projects Finance Authority of Florida, Student Housing Revenue, Capital Projects Loan Program, Florida University, Series A, 7.850% due 8/15/31 (b)(d)	2,426,820
2,000,000	NR	Capital Projects Finance Authority, FL, Continuing Care Retirement Glenridge on Palmer Ranch, Series A, 8.000% due 6/1/32 (d)	2,220,960
965,000	NR	Century Parc Community Development District, Special Assessment, 7.000% due 11/1/31	1,013,231
1,000,000	A+	Highlands County, FL, Health Facilities Authority Revenue, Adventist Health Systems, Series D, 6.000% due 11/15/25	1,085,170
1,000,000	Aaa(f)	Hollywood, FL, FGIC-Insured, 5.000% due 6/1/26	1,044,060
830,000	NR	Homestead, FL, IDR, Community Rehabilitation Providers Program, Series A, 7.950% due 11/1/18	837,171

See Notes to Financial Statements.

Face Amount	Rating	Security	Value
Florida 12.5% (continued)			
$ 2,000,000	BB+	Martin County, FL, IDA Revenue, Indiantown Cogeneration Projects, Series A, 7.875% due 12/15/25 (c)(d)	$ 2,066,560
1,000,000	NR	Orange County, FL, Health Facilities Authority Revenue, First Mortgage, GF, Orlando Inc. Project, 9.000% due 7/1/31	1,074,470
495,000	AAA	Palm Beach County, FL, Health Facilities Authority Revenue, John F. Kennedy Memorial Hospital Inc. Project, 9.500% due 8/1/13 (g)	610,855
2,000,000	NR	Reunion East Community Development District, Special Assessment, Series A, 7.375% due 5/1/33 (d)	2,186,780
1,000,000	B-	Santa Rosa, FL, Bay Bridge Authority Revenue, 6.250% due 7/1/28	1,004,940
1,000,000	AAA	University of Central Florida, COP, Series A, FGIC-Insured, 5.000% due 10/1/25	1,029,100
1,485,000	NR	Waterlefe, FL, Community Development District, Golf Course Revenue, 8.125% due 10/1/25	1,489,024
		Total Florida	20,820,051
Georgia 4.2%			
		Atlanta, GA, Airport Revenue:	
1,000,000	AAA	Series B, FGIC-Insured, 5.625% due 1/1/30 (c)	1,045,850
1,000,000	AAA	Series G, FSA-Insured, 5.000% due 1/1/26	1,035,620
2,500,000	NR	Atlanta, GA, Tax Allocation, Atlantic Station Project, 7.900% due 12/1/24 (d)	2,732,225
1,000,000	NR	Gainesville & Hall County, GA, Development Authority Revenue, Senior Living Facilities, Lanier Village Estates, Series C, 7.250% due 11/15/29	1,072,940
1,005,000	NR	Walton County, GA, IDA Revenue, Walton Manufacturing Co. Project, 8.500% due 9/1/07	1,030,798
		Total Georgia	6,917,433
Illinois 1.3%			
2,000,000	AAA	Chicago, IL, GO, Neighborhoods Alive 21 Program, FGIC-Insured, Call 1/1/11 @ 100, 5.500% due 1/1/31 (b)(d)	2,184,320
Indiana 2.1%			
2,500,000	BBB	East Chicago Industrial, PCR, IN, Inland Steel Co. Project Number 10, 6.800% due 6/1/13 (d)	2,503,125
1,000,000	BBB-	Indiana State Development Finance Authority, PCR, Inland Steel Co. Project Number 13, 7.250% due 11/1/11 (c)	1,035,630
		Total Indiana	3,538,755
Louisiana 0.6%			
1,000,000	NR	Epps, LA, COP, 8.000% due 6/1/18	1,028,140
Maryland 1.0%			
1,500,000	NR	Maryland State Economic Development Corp. Revenue, Chesapeake	

Bay, Series A, 7.730% due 12/1/27	1,581,435

See Notes to Financial Statements.

Face Amount	Rating	Security	Value
Massachusetts 4.2%			
$ 955,000	NR	Boston, MA, Industrial Development Financing Authority Revenue, Roundhouse Hospitality LLC Proje	