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Sensex falls on Mauritius tax treaty review talk

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MUMBAI (Reuters) - The BSE Sensex fell as much as 3.1 percent on Monday on market talk the government is reviewing a tax treaty with Mauritius, triggering jitters foreign inflows could take a hit.

A large proportion of foreign investment in the stock market comes through companies registered in the Indian Ocean island and are exempted from tax in India under a Double Taxation Avoidance Agreement with Mauritius.

The two countries are expected to review the treaty soon, a source in the finance ministry said, but declined to elaborate on the time-frame.

Following a series of corruption scandals in high places the government has come under intense pressure to plug loopholes from tax havens.

Overseas funds hold more than $100 billion of Indian shares, accumulated since India opened the door to foreign institutional investors in 1992, data from the Securities and Exchange Board of India showed.

"The treaty with Mauritius is being renegotiated. But it is too premature to say all the foreign investments through Mauritius will get hampered," said Siddharth Shah, head of funds practice group, Nishith Desai Associates.

Traders said the market talk could not have come at a worse time with shares already reeling under rising interest rates and slowing growth.

The 30-share BSE index hit 17,314.38, its lowest since Feb. 11, before paring losses to 1.3 percent by 12:12 p.m. (0642 GMT) at 17,641.95. Twenty-seven components were in the red.

"The talk over Mauritius tax treaty is adding fuel to fire," said Arun Kejriwal, director of research firm KRIS. "The news flow at large has been negative. The market is vulnerable."

Foreign funds who are exempted from capital gains tax in India had sold shares worth about $330 million last week. There has been a net outflow for the year to date.

Network engineering services provider GTL (GTL.NS: Quote, Profile, Research) nosedived 62.3 percent to 127.50 rupees, its lowest level since December 2006, while group firm GTL Infra (GTLI.NS: Quote, Profile, Research) slumped as much as 48.5 percent to a life-time low of 15.25 rupees.

(Also read: Fundamentals strong despite stock drop - GTL, click here)

Dealers said GTL shares plunged on speculation of a possible default in debt repayment. Company Chairman Manoj Tirodkar told CNBC-TV18 he believes he has not defaulted and the fundamentals of business remain strong.

Mobile operator Reliance Communications and utility Reliance Infrastructure, controlled by billionaire Anil Ambani, slid 6.5 and 6.7 percent respectively after the Bombay Stock Exchange said they would be removed from the Sensex from Aug. 8.

The two companies will be replaced by state-run Coal India, the world's largest coal miner, and drugmaker Sun Pharmaceutical Industries, which gained 2.3 percent and 2.1 percent respectively.

Around 452 million shares were dealt on the NSE, with losers overwhelming gainers in the ratio of 11:1

The 50-share NSE index was down 1.9 percent at 5,266.65.

STOCKS ON THE MOVE

* Bharti Airtel was up 1.9 percent at 387.90 rupees after data from an industry body showed the top mobile carrier signed up 2.45 million mobile subscribers in May, taking its total to 167.1 million.

* Cadila Healthcare rose 0.7 percent to 905.95 rupees after K-V Pharmaceutical Co said it agreed to

sell its generic business unit to the Indian drugmaker's unit Zydus Pharmaceuticals for $60 million in cash.

TOP THREE MAIN STOCKS BY VOLUME ON NSE

* GTL Infra on 71.1 million shares

* GTL on 29.2 million shares

* Lanco Infratech on 14 million shares

(Reporting by Ami Shah and Indulal PM; Additional reporting by Manoj Kumar in NEW DELHI; Editing by Ranjit Gangadharan)